

EXPLAINING THE DIFFERING  
U.S. AND EU POSITIONS ON THE  
BOEING/MCDONNELL-DOUGLAS MERGER:  
AVOIDING ANOTHER NEAR-MISS

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1. BACKGROUND

Given the way that the controversy over the Boeing/McDonnell-Douglas merger was portrayed in the media, one might conclude that the dispute was solely about U.S. and EU authorities attempting to protect their national interests and their own “national champion” aircraft manufacturer. As has been previously pointed out,<sup>1</sup> however, the Boeing/McDonnell-Douglas merger raised a number of controversial economic and legal questions, and the differing conclusions reached on opposite sides of the Atlantic can also be explained by fundamental differences in the legal philosophies and economic assumptions of the U.S. and European merger-review authorities. This article attempts to identify and elaborate on some of these differences as manifested in the opposing conclusions in the Boeing/McDonnell-Douglas case. Without attempting to resolve which enforcement body’s approach is preferable, the article identifies various limitations and questionable economic assumptions underlying each body’s analysis and concludes that both sides of the Atlantic could benefit from a more balanced and comprehensive approach.

The article begins, in Section 1, by providing the background for the dispute over the Boeing/McDonnell-Douglas merger, including: (1) identifying the U.S. and EU bodies responsible for

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<sup>1</sup> See, e.g., Eleanor M. Fox, *Antitrust Regulation Across National Borders: The United States of Boeing Versus the European Union of Airbus*, BROOKINGS REV., Winter 1998, at 30.

enforcing the antitrust laws and, in particular, for reviewing horizontal mergers for compliance with those laws; (2) explaining the basic goals and emphases of U.S. and EU antitrust law, with a focus on horizontal mergers; and (3) briefly presenting the recent history of the commercial aircraft market in order to provide the context in which the respective merger review bodies analyzed the proposed merger. Section 2 attempts to explain why the United States and the European Union came to conflicting conclusions as to whether the merger would harm competition in the commercial aircraft market. After discussing why both merger review authorities considered the merger, on its face, to raise serious anticompetitive concerns, Section 2 explains why differing legal philosophies and contrasting economic assumptions caused the two bodies to reach different conclusions with respect to three important aspects of the merger: (1) the "competitive potential" of McDonnell-Douglas in the commercial aircraft market; (2) the significance of the fact that enormous efficiencies were expected to be generated by the merger; and (3) the importance and relevance of the exclusive supply contracts that had been entered into between Boeing and three major U.S. airlines. Section 3 sets forth the settlement that was eventually reached between the European Union and Boeing, and, with the aid of two years of hindsight, provides a brief substantive critique of the U.S. and EU enforcement bodies' analyses of the merger.

### 1.1. *The U.S. and EU Antitrust Authorities*

Authority for reviewing mergers for compliance with the antitrust laws exists on a multitude of levels in both the United States and the European Union. Merger control authority in the United States is delegated primarily to two federal agencies: the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"). In addition, each state, through its attorney general, is entitled to enforce its own antitrust laws, although only a few have true merger control laws.<sup>2</sup> Federal

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<sup>2</sup> See Jason A. Garick, *International Horizontal Mergers: A Comparison of European Union and United States Regulatory Policy and Procedure*, 7 TRANSNAT'L L. 293, 294 (1994). Although every state has its own antitrust laws, only twelve have merger control regulations: Alaska, Hawaii, Louisiana, Maine, Mississippi, Nebraska, New Jersey, Ohio, Oklahoma, Oregon, Texas, and Washington. See Barry E. Hawk & Laraine L. Laudati, *Antitrust Federalism in the United States and Decentralization of Competition Law*

approval of a proposed international horizontal merger in the United States does not prevent individual states from acting alone.<sup>3</sup> However, because most states have limited amounts of resources, by far the primary governmental<sup>4</sup> bodies engaged in real merger-regulation are the FTC and DOJ.<sup>5</sup> Similarly, in the European Union, merger enforcement occurs at both the member state and EU levels. However, only one body will obtain the right to challenge the merger, depending on whether the merger meets certain "thresholds."<sup>6</sup> The EU authorities have jurisdiction when a merger's impact is: (1) large enough to give it a "Community Dimension," and (2) diffuse enough such that its impact is not primarily confined to one member state.<sup>7</sup>

In the United States, the DOJ enforces the Sherman Act<sup>8</sup> and, jointly with the FTC, the Clayton Act.<sup>9</sup> Since horizontal merger review falls under the rubric of Section Seven of the Clayton Act, the DOJ effectively shares enforcement duties with the FTC. The DOJ and FTC (jointly referred to as the "Agencies") developed a common agency framework for evaluating horizontal mergers, which they published most recently in the 1992

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*Enforcement in the European Union: A Comparison*, 20 FORDHAM INT'L L.J. 18, 21 n.13 (1996).

<sup>3</sup> See Garick, *supra* note 2, at 294.

<sup>4</sup> In the United States, private plaintiffs are also permitted to sue to enjoin a merger that violates the antitrust laws. See 15 U.S.C. § 15 (1994). It is more difficult for a competitor of the merging companies to sue because of the requirement of "antitrust injury." See *Cargill, Inc. v. Monfort of Colorado, Inc.*, 479 U.S. 104 (1986) (prohibiting the country's fifth largest beef packer from challenging a merger between the second and third largest meatpackers). Firms that do business with the merging companies, however, may use private suits as a method of preventing perceived anticompetitive mergers.

<sup>5</sup> There was a noticeable rejuvenation of state antitrust enforcement in the 1980s because of the drop in federal enforcement. See Hawk & Laudati, *supra* note 2, at 20.

<sup>6</sup> See Council Regulation 4064/89 of 21 December 1989, Control of Concentrations Between Undertakings, art. 1, 1990 O.J. (L 257) 14, 16 [hereinafter EU Merger Regulation] (asserting EU-level authority when either: (1) the combined world aggregate turnover of the merging companies is over ECU 5 billion, or where (2) both the turnover in the European Union is over ECU 250 million, and each of the merging firms does not possess over two-thirds of its turnover in one particular member state).

<sup>7</sup> See *id.*

<sup>8</sup> See 15 U.S.C. §§ 1-9 (1994).

<sup>9</sup> See *id.* § 18.

Horizontal Merger Guidelines.<sup>10</sup> The DOJ does not have the authority to block a merger on its own—it must commence an action to enjoin the merger under the applicable statute in federal district court. The DOJ is headed by the Attorney General of the United States, who is appointed by the President for an indefinite term. The Antitrust Division of the DOJ is headed by an assistant attorney general, also appointed for an indefinite term. At the time of the Boeing/McDonnell-Douglas merger, the Attorney General was Janet Reno.

The FTC is an independent regulatory agency that was created by the Federal Trade Commission Act<sup>11</sup> and which enforces the Clayton Act and the Robinson-Patman Act.<sup>12</sup> The FTC, unlike the DOJ, has full authority to investigate, prosecute, and adjudicate applications for merger approval. A decision by an administrative law judge in favor of the prosecuting arm of the FTC—thus blocking the merger—can be appealed first to the full commission, and then to a federal appeals court.<sup>13</sup> The FTC is headed by five commissioners appointed by the President for seven year terms, during which they cannot be removed except “for cause.”<sup>14</sup> The division of the FTC responsible for evaluating mergers is the Bureau of Competition. At the time of the Boeing/McDonnell-Douglas merger, the Chairman of the FTC was former Georgetown Law professor Robert Pitofsky.

In the European Union, mergers that meet the applicable thresholds are reviewed by the Commission of the European Communities (“European Commission” or “Commission”). The Commission is usually considered the executive branch of the European Union, although it exercises “a melange of all the

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<sup>10</sup> See 1992 Horizontal Merger Guidelines (visited Nov. 17, 1999) <http://www.ftc.gov/bc/docs/horizmer.htm> [hereinafter Horizontal Merger Guidelines]. The 1992 guidelines were modified in 1997 to reflect a more favorable view of efficiencies but are still referred to as the 1992 Horizontal Merger Guidelines. Unless otherwise stated, the references within this article pertain to the 1997 version.

<sup>11</sup> See 15 U.S.C. §§ 41 (1999).

<sup>12</sup> See *id.* § 13 (dealing with “discrimination in price, services, or facilities”).

<sup>13</sup> See *id.* § 45(c).

<sup>14</sup> Commissioners may only be removed for “inefficiency, neglect of duty, or malfeasance in office.” *Humphrey’s Ex’r v. United States*, 295 U.S. 602, 623 (1935).

branches' functions."<sup>15</sup> The members of the Commission are appointed by member states to serve five-year terms.<sup>16</sup> The Commission's work is primarily done by civil servants, divided into twenty-three Directorates-Generale.<sup>17</sup> Directorate General IV ("DG IV") is responsible for competition matters, including merger regulation, but final decisions must be approved by the entire twenty member Commission.<sup>18</sup> The Commission is often considered to be subject to somewhat more political pressure than the U.S. regulatory authorities, but it has proven its ability to make politically unpopular decisions.<sup>19</sup> The Commission has the authority to investigate, prosecute, and adjudicate all issues related to the merger. A final ruling by the Commission may, however, be appealed to the European Court of Justice.<sup>20</sup> A Minister of Competition, at the head of DG IV, is generally responsible for investigating mergers for the Commission. At the time of the Boeing/McDonnell-Douglas merger, the EU Competition Minister was Karel Van Miert, a Commissioner from Belgium.

## 1.2. *A General Difference in Focus*

One formulation of the general economic purposes of merger regulation is to prevent the use of mergers to "enhance market power or facilitate its exercise."<sup>21</sup> There are, generally, at least

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<sup>15</sup> Alissa A. Meade, Note, *Modeling A European Competition Authority*, 46 DUKE L.J. 153, 157 (1996).

<sup>16</sup> See *id.* at 157 n.18 (citing JOSEPHINE SHAW, EUROPEAN COMMUNITY LAW 54 (1993)).

<sup>17</sup> See *id.* at 157.

<sup>18</sup> See Hawk & Laudati, *supra* note 2, at 31.

<sup>19</sup> See, e.g., Per Jebsen & Robert Stevens, *Assumptions, Goals, and Dominant Undertakings: The Regulation of Competition Under Article 86 of the European Union*, 64 ANTITRUST L.J. 443, 451-52 (1996) ("While Politics is not absent from the [DOJ] or [FTC], it is less obvious than in the Commission, where the twenty commissioners represent fifteen political and legal systems."). A number of recent commentators have criticized the vulnerability of the Commission to political pressure and, in particular, lobbying from member states. See, e.g., Meade, *supra* note 15, at 167 n.78. The Commission's controversial decision to block a merger in de Havilland, however, was against intense lobbying efforts by some member states. See *infra* text accompanying notes 125-128 (discussing Commission Decision IV/M.053, *Re the Concentration Between Aerospatiale SNI and Aleni-Aeritalia E Selenia SpA and de Havilland*, 1991 O.J. (L 334) 42, 4 C.M.L.R. M2 (1992) [hereinafter *de Havilland*]).

<sup>20</sup> See Garick, *supra* note 2, at 298.

<sup>21</sup> Horizontal Merger Guidelines, *supra* note 10, § 0.1.

three identifiable ways that market power can be exercised, which were well summarized by Robert Pitofsky in 1992:

[M]ergers can provide a convenient route to monopoly as firms buy out rivals and then raise prices to consumers. Mergers are also a matter of concern because when only a few firms account for all or most sales of a product, they may be able to behave like monopolists and more easily coordinate their sales policies to extract higher prices and earn greater profits at the expense of consumers. Beyond these specific concerns . . . there is a generalized view that, in noncompetitive markets, incentives to achieve efficiency, to innovate and to drive down prices will diminish.<sup>22</sup>

Monopoly creation, cartel facilitation, and generally lethargic enterprise can be referred to as the three dangers of mergers. The concerns regarding monopoly creation should not be narrowly constricted, as the Merger Guidelines explain that "[c]ircumstances . . . may permit a single firm, not a monopolist, to exercise market power through unilateral or non-coordinated conduct."<sup>23</sup> Similarly, cartel facilitation may be understood also to include problems of conscious parallelism and tacit collusion. Finally, the term "lethargic enterprise" is used here to connote a lack of dynamism, and to imply that firms will have diminished incentives to initiate beneficial improvements, such as lowering costs and developing new technologies.

Mergers pose the dangers of monopoly creation, cartel facilitation, and lethargic enterprise, because the likelihood of these problems rises, to varying degrees, with: (1) the market share of the leading firm, and (2) overall market concentration. A brief summary of current U.S. and EU practice in merger control illustrates that EU law is more concerned with monopoly creation and the complacency of a market-dominating firm,

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<sup>22</sup> Robert Pitofsky, *Proposals for Revised United States Merger Enforcement in a Global Economy*, 81 GEO. L.J. 195, 195 (1992) (footnote omitted) (written before the author was an FTC Commissioner) [hereinafter Pitofsky, *Proposals*].

<sup>23</sup> See Horizontal Merger Guidelines, *supra* note 10, § 0.1.

whereas U.S. merger review appears relatively more concerned with cartel facilitation and market-wide lethargy.

U.S. law reflects, to an extent, all three of the above concerns in Section Seven of the Clayton Act, which prohibits mergers whose effects "may be substantially to lessen competition, or to tend to create a monopoly."<sup>24</sup> The U.S. enforcement bodies interpret this statute as requiring them to prevent mergers that will create or facilitate the exercise of market power.<sup>25</sup> The 1992 Horizontal Merger Guidelines define market power as "the ability profitably to maintain prices above competitive levels for a significant period of time" or to lessen competition in product quality, service, or innovation.<sup>26</sup> In deciding whether a horizontal merger may have anti-competitive effects, U.S. merger law relies to a large extent on market share statistics of the merging firms and other leading firms in the industry.

Despite the statutory neutrality, scholars have asserted that, empirically, "coordinated interaction is the principal [U.S.] enforcement concern."<sup>27</sup> Although the 1992 Horizontal Merger Guidelines discuss the increased dangers of both coordination and unilateral conduct, the previously issued 1984 Horizontal Merger Guidelines concentrated extensively on the problem of collusion and addressed only briefly the risk of anticompetitive effects from unilateral activity.<sup>28</sup> Among possible historical factors that could have contributed to this focus is the fact that antitrust policy began in the United States with the Sherman Act as a powerful populist attack on the rise of the industrial trusts that had permitted the industrialists of the late 1800s to coordinate their prices and control their industries at the expense of consumers.<sup>29</sup> Although current U.S. law recognizes the danger that mergers can lead to anti-competitive unilateral conduct, agency practice tends

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<sup>24</sup> 15 U.S.C. §18 (1994).

<sup>25</sup> See Horizontal Merger Guidelines, *supra* note 10, § 0.1.

<sup>26</sup> *Id.* § 0.1 n.6.

<sup>27</sup> BARRY E. HAWK & HENRY L. HUSER, EUROPEAN COMMUNITY MERGER CONTROL: A PRACTITIONER'S GUIDE 216 (1996).

<sup>28</sup> See ABA ANTITRUST SECTION, THE 1992 HORIZONTAL MERGER GUIDELINES: COMMENTARY AND TEXT 12-13 (1992) (indicating that the 1984 Guidelines mentioned unilateral conduct briefly under the discussion of the "Leading Firm Proviso").

<sup>29</sup> See Eleanor M. Fox & Lawrence A. Sullivan, *Antitrust—Retrospective and Prospective: Where Are We Coming From? Where Are We Going?*, 62 N.Y.U. L. REV. 936, 939-40 (1987).

to indicate that collusion and coordination between competitors persist as the stronger focus of merger regulation.

EU law, on its face, appears to have a comparably greater focus on preventing anticompetitive conduct committed by the leading firm of an industry. Article 2 of the EU Merger Regulation, adopted in December 1989, declares a merger to be incompatible with the common market if it "creates or strengthens a dominant position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it."<sup>30</sup> Generally, the European Commission follows the definition of "dominant position" as derived from the principles established by the European Court of Justice ("ECJ") in connection with Article 86 of the Treaty of Rome ("Article 86").<sup>31</sup> This jurisprudence defines a dominant position as "economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its [immediate] customers, and ultimately of the consumers [of the final product]."<sup>32</sup>

One commentator describes cartel-like behavior (or "multi-firm dominance") under the EU Merger Regulation as the "'poor cousin' to single firm dominance."<sup>33</sup> The European Court of

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<sup>30</sup> EU Merger Regulation, *supra* note 6, art. 2, § 3.

<sup>31</sup> See Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 86, 298 U.N.T.S. 11, 48-49; Joseph P. Griffin & LeeAnne T. Sharp, *Efficiency Issues in Competition Analysis in Australia, the European Union, and the United States*, 64 ANTITRUST L.J. 649, 667 (1996) ("The Commission has adopted for use in the Merger Regulation the definition of 'dominance' formulated in relation to Article 86."). Article 86 prohibits the abuse of a dominant position and is the analog of Section 2 of the Sherman Act in U.S. antitrust law. See *id.* There is some debate as to whether it is appropriate to directly transfer the ECJ's definitions from Article 86 to Article 2 of the Merger Regulation. See, e.g., Alessandro Bertolini & Francesco Parisi, *The Rise of Structuralism in European Merger Control*, 32 STAN. J. INT'L. L. 13, 24-26 (1996). One commentator explains that the Commission uses the definition and language from its Article 86 jurisprudence, while applying the concept in a novel manner. See Sergio Baches Opi, *Merger Control in the United States and European Union: How Should the United States' Experience Influence the Enforcement of the Council Merger Regulation?*, 6 J. TRANSNAT'L L. & POL'Y 223, 272-74 (1997).

<sup>32</sup> Case 85/76, *Hoffman-La Roche & Co. AG v. Commission*, 1979-2 E.C.R. 461, 462 (1979); see also Bertolini & Parisi, *supra* note 31, at 26 (explaining the ECJ's definition of a dominant position).

<sup>33</sup> HAWK & HUSER, *supra* note 27, at 216.



Justice has emphasized that dominant conduct is not comparable to parallel oligopolist conduct.<sup>34</sup> In theory, one could argue that the Regulation arguably does not even *address* anticompetitive problems arising out of a merger unless the merger involves, or will create, a market leader. As one commentator notes:

One can argue that the substantive test . . . means that you cannot violate the Regulation unless the resulting combined entity becomes number one in a market. There has never been a case [as of 1990] where someone had a dominant position unless they were number one. So, unless you end up number one, you can't violate the Regulation.<sup>35</sup>

Scholars have confirmed that "[it] may thus be argued that the preventive antitrust policy introduced by the Merger Regulation is limited to mergers creating or reinforcing single-firm dominance."<sup>36</sup> Recent cases such as *Nestle/Perrier*<sup>37</sup> illustrate that the European Commission has begun to use the Merger Regulation to prevent "collective dominance" in oligopolistic markets,<sup>38</sup> but the relative focus of EU law on single-firm dominance remains.

It has been shown that the EU Merger Regulation is concerned with the creation or strengthening of dominant positions, while U.S. law focuses more generally on the structure of the entire market. In other words, U.S. merger review law focuses on insuring a market structure that will prevent oligopolistic coordination and preserve competition to keep the leading firm or firms in line, while EU merger law focuses on

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<sup>34</sup> See Bertolini & Parisi, *supra* note 31, at 26 (citing Case 85/76, Hoffman-La Roche, *supra* note 32).

<sup>35</sup> Barry E. Hawk, *European Economic Community Merger Regulation*, 59 ANTITRUST L. J. 457, 463 (1990).

<sup>36</sup> Bertolini & Parisi, *supra* note 31, at 26.

<sup>37</sup> Commission Decision 92/553, Re Proceeding Under Council Regulation EEC No 4064/89, Case No. IV/M190–Nestle/Perrier, 1992 O.J. (L 356) 1 [hereinafter *Nestle/Perrier*] (blocking a merger because of a finding that, in the concentrated market, it would strengthen the ability of the merged firm to exercise "collective dominance" with competitors).

<sup>38</sup> See *id.* at 1; see generally Bertolini & Parisi, *supra* note 31 (discussing in depth this recent development in EU law).

preventing the leading firm from strengthening and abusing its position in the market through acquisitions. This difference is clear in practice and is recognized by enforcement officials. As one member of the FTC has recently stated, "it is fair to say that the EC focuses more on single firm dominance and the United States focuses more on oligopoly coordination."<sup>39</sup> In terms of preventing the three anticompetitive dangers noted above, the EU law centers around the market leader, while U.S. law focuses on the market more generally.

There are a number of philosophical rationales that may animate an increased focus in the European Union on the leading firm of an industry relative to the United States. First, U.S. law has moved away from viewing the concentration of economic power as an evil outside of the risk of economic deadweight losses and reduced incentives to innovate.<sup>40</sup> Although U.S. antitrust law originated with many populist ideas, it has subsequently evolved to place significant emphasis on economic analysis. In particular, U.S. law has become principally concerned with whether particular behavior will, over the long run, lead to improvements in allocative efficiency and/or increases in consumer welfare.<sup>41</sup> Chairman Pitofsky has stated, for example, that "[i]n the United States [as compared to Europe], the emphasis is less on competitors and 'competitive leverage,' and more on the effect of a merger on future prices."<sup>42</sup>

This focus on overall effects leaves much more room to consider the beneficial welfare effects of mergers, which makes larger and more dominant firms much more tolerable when these firms will possess welfare-enhancing attributes, such as economies of scale. Further, the influence of the so-called "Chicago School" in U.S. law has resulted in various assumptions that migrate fears of the concentration of monopoly power, suggesting that most markets are indeed competitive,<sup>43</sup> that "monopoly tends to be self-

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<sup>39</sup> Debra A. Valentine, *Building a Cooperative Framework for Oversight in Mergers—The Answer to Extraterritorial Issues in Merger Review*, 6 GEO. MASON L. REV. 525, 528 (1998).

<sup>40</sup> See Jebson & Stevens, *supra* note 19, at 449, 454.

<sup>41</sup> See *id.*

<sup>42</sup> Robert Pitofsky, *Address Before the Business Development Associates, Staples and Boeing: What They Say About Merger Enforcement at the FTC* (Sept. 23, 1997) <<http://www.ftc.gov/speeches/pitofsky/STAPLESspc.htm>> [hereinafter Pitofsky, Staples Speech].

<sup>43</sup> See Jebson & Stevens, *supra* note 19, at 456.

correcting because the monopolist's higher profits attract new entrants . . .,"<sup>44</sup> and that barriers to entry are usually not influential in the long term.<sup>45</sup> It has also be observed that, in contrast to efficiencies that may be generated by dominant firms, coordinated pricing has little, if any, welfare-enhancing effects.

EU law appears to operate from an economic premise more hospitable to the likelihood of monopoly power being exerted by the leading firm.<sup>46</sup> An example can be seen in the area of predatory pricing. Modern U.S. case law finds it extremely unlikely that predatory pricing can and would occur—at least successfully.<sup>47</sup> However, the ECJ finds the likelihood of this practice occurring to be much greater, and, in the European Union, a much broader range of behavior is prohibited. Unlike in the United States, it is possible that pricing above cost would still result in sanctions for predatory pricing if the pricing is combined with "abusive intent."<sup>48</sup> Similarly, the ECJ has stated that "if prices are below average total costs . . . but above average variable costs, those prices must be regarded as abusive if they are determined as part of a plan for eliminating a competitor."<sup>49</sup>

Non-economic considerations may also partly underlie the EU's stronger concern with leading or "dominant" firms. The EU merger analysis, although significantly driven by economics, is more explicit in permitting the consideration of non-economic factors.<sup>50</sup> As the former EU Competition Commissioner Karel Van Miert has stated:

The aims of European Community's competition policy are economic, political and social. The policy is concerned not only with promoting efficient production but also

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<sup>44</sup> See *id.*

<sup>45</sup> See *id.* (citing Fox & Sullivan, *supra* note 29, at 974).

<sup>46</sup> It is possible that, because of the large area of the U.S. market in comparison to European nations, collusion among many firms in the United States has generally been more common historically than single firm dominance.

<sup>47</sup> See, e.g., *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

<sup>48</sup> See Jebsen & Stevens, *supra* note 19, at 495.

<sup>49</sup> Case T-83/91, *Tetra Pak Int'l SA v. Commission*, 1994 E.C.R. II-755.

<sup>50</sup> See Barry E. Hawk, *The American (Anti-trust) Revolution: Lessons for the EEC?*, 9 EUR. COMPETITION L. REV. 53, 56-57 (1988).

achieving the aims of the European treaties. . . . To this must be added the need to safeguard a pluralistic democracy, which could not survive a strong concentration of economic power.<sup>51</sup>

One possible implication of the EU's apparent relative de-emphasis of consumer welfare is that EU law may protect competition at times even if it may be at the *expense* of consumers—at least in the short run. For example, "when considering factors in addition to market share, [EU merger-review authorities] are likely to find damning those qualities, such as excellent technology or customer service, that generally would win praise in American courts."<sup>52</sup> This will be discussed later in the context of the efficiencies generated by the Boeing/McDonnell-Douglas merger.<sup>53</sup>

Thus, EU Merger law, as compared to U.S. law, focuses more on the leading firm and less on the possibility of explicit or tacit collusion between competitors. As stated above, this leads EU authorities to analyze the merger in terms of monopoly-creation and leading firm lethargy, while U.S. regulators have a relatively greater focus on cartel facilitation and general market responsiveness to consumer interests. These differences will be illustrated further in the context of the Boeing/McDonnell-Douglas merger.

### 1.3. *The Commercial Aircraft Market and the Events Leading up to the Merger*

As *The Economist* has reported, "[a]ny account of the civil-aircraft industry must begin with the caveat that it has never had free and fair competition."<sup>54</sup> The defense and commercial aircraft sectors, in addition to being inter-dependent, are considered to be two of the most politicized industries in the global economy today.<sup>55</sup> For example, in the years preceding the

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<sup>51</sup> Jebsen & Stevens, *supra* note 19, at 450 (quoting EU Competition Commissioner Karel Van Miert).

<sup>52</sup> *Id.* at 479.

<sup>53</sup> See discussion *infra* Section 2.3.

<sup>54</sup> *Peace in Our Time: Boeing v. Airbus*, THE ECONOMIST, July 26, 1997, at 59.

<sup>55</sup> See *id.*

Boeing/McDonnell-Douglas merger (the "Merger"), President Clinton intervened in order to win sales for Boeing and the McDonnell-Douglas Corporation ("MDC") in Saudi Arabia,<sup>56</sup> China,<sup>57</sup> and Israel.<sup>58</sup> Airbus Industrie ("Airbus") was created by Western European governments that were concerned that Boeing, MDC, and Lockheed (active in the commercial market until 1981) would wipe out their weak and divided industry.<sup>59</sup> Airbus was founded in 1970 and developed into a "consortium" of four independent companies that together build commercial aircraft.<sup>60</sup> These four European companies were, at the time of the Boeing/MDC merger, France's Aerospatiale SA with 37.9%, Germany's Daimler-Benz Aerospace AG with 37.9%, British Aerospace PLC with 20%, and Spain's Construcciones Aeronauticas S.A. ("CASA") with 4.2%.<sup>61</sup>

The United States' anger at European subsidies to Airbus resulted in a 1978 U.S. threat to impose anti-dumping duties on Airbus planes ordered by Eastern Airlines.<sup>62</sup> No duties were assessed, but by the 1980's, there were increasing complaints from Boeing about the \$10 billion to date in European subsidies.<sup>63</sup> Although the dispute was very visible, Boeing hesitated to take any action that could result in an altercation and its exclusion from the European market. Finally, a bilateral deal was signed in

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<sup>56</sup> See *id.*

<sup>57</sup> See Robert S. Greenberger & Ian Johnson, *U.S.-China Summit Brings in Business*, WALL ST. J., Oct. 30, 1997, at A18. The Asian market has been particularly sensitive to political considerations, as more recent political maneuvering demonstrates. See Paul Blustein, *U.S. Pressing Taiwan on Boeing's Behalf*, WASH. POST, Aug. 7, 1999, at E9 (reporting U.S. diplomacy in reaction to Taiwanese suggestions that its flagship airline might purchase planes from Airbus and that Boeing maintains an edge in the Japanese market because of the close relationship between the United States and Japan).

<sup>58</sup> See Polly Lane, *Jet Sales Now as Much a Diplomatic Tool as Economic*, SEATTLE TIMES, Jan. 4, 1998, at F1.

<sup>59</sup> See *Peace in Our Time: Boeing v. Airbus*, *supra* note 54, at 59.

<sup>60</sup> See *Commercial Battle Goes On as Airbus Reaches 25*, AGENCE FRANCE PRESSE, Oct. 27, 1997.

<sup>61</sup> See Charles Goldsmith, *Aerospatiale to Form Unit for Its Airbus Activities*, WALL ST. J. EUR., Jan. 14, 1998, at 7. These four partners have undergone major changes subsequent to the Boeing/MDC merger. See *infra*, notes 371-74 and accompanying text.

<sup>62</sup> See *Peace in Our Time: Boeing v. Airbus*, *supra* note 54, at 61.

<sup>63</sup> See *id.*

1992, which limited subsidies to 33% of the cost of developing a new model of aircraft.<sup>64</sup>

Problems persisted, however, especially with regard to the "jumbo jet" market. Boeing's 747 is currently the only available jet of its size and earns extraordinary profits; for example, it has been reported that in 1997 Boeing made a net profit of nearly \$45 million out of the purchase price of \$150 million.<sup>65</sup> After discussions between Boeing and Airbus concerning a possible joint venture to create a new jet collapsed in 1995, the chief executive of Airbus stated his belief that the entire affair was a ruse to delay Airbus' development of its own proposed "A3XX" double-decker jumbo—which would supposedly be 20% cheaper to build than the 747.<sup>66</sup> By this time, there were only three remaining major players in the commercial aircraft market (Boeing, Airbus, and Douglas Aircraft Corp. ("DAC"), which is MDC's commercial aircraft unit) and DAC's significance in the market was fading.

Meanwhile, in the interrelated U.S. defense industry, a devastating drop in money for defense procurement led to vast industry over capacity. When adjusted for inflation, it has been reported that defense spending dropped 71% and that companies were operating in some areas at 20-30% capacity by 1996.<sup>67</sup> The industry responded with rapid consolidation; it has been estimated that more than 300 defense-related mergers and acquisitions occurred between 1980 and 1995.<sup>68</sup> The U.S. Department of Defense supported this consolidation, especially because the cost-based nature of defense contracts results in the U.S. government directly paying for the excess capacity.<sup>69</sup> Among the mergers that directly preceded the Boeing/MDC deal were the \$23 billion mega-merger of Lockheed with Martin Marietta that created Lockheed-Martin,<sup>70</sup> the \$2.3 billion merger

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<sup>64</sup> See *id.*

<sup>65</sup> See *id.* at 62.

<sup>66</sup> See *id.*

<sup>67</sup> See Marina Lao, *Mergers in a Declining Defense Industry: Should the Merger Guidelines Be Re-Assessed?*, 28 CONN. L. REV. 347, 351 (1996).

<sup>68</sup> See *id.* at 391 n.88 (citing Report of the Defense Science Board Task Force on Antitrust Aspects of Defense, 66 ANTITRUST & TRADE REG. REP. (BNA) Special Supp. at S10, Apr. 14, 1994).

<sup>69</sup> See Lao, *supra* note 67, at 363.

<sup>70</sup> See Richard M. Weintraub & Sharon Walsh, *Toward a More Perfect Union: With the Lockheed-Martin Marietta Match Come Antitrust, Competition*

of Raytheon and E-Systems,<sup>71</sup> and Boeing's previous acquisition on December 6, 1996 of \$3.2 billion worth of Rockwell's defense and space business.<sup>72</sup>

Boeing and MDC announced their proposed merger on December 15, 1996 in this context. McDonnell-Douglas' prospects had been getting dimmer, and its desire for a merger was becoming stronger, ever since it was eliminated, in favor of Boeing and Lockheed-Martin, from the high stakes competition for a \$200 billion contract to build the Pentagon's new Joint Strike Fighter—a devastating loss that sent MDC shares down 8% in a single day.<sup>73</sup> Two advantages of the merger that were frequently cited by the media involved its creation of a “better balance” between defense and commercial aircrafts due to the two firms' complementary product lines, and involved the ability of Boeing to use MDC's capacity and work force to help meet its current order backlog and the expected imminent surge in demand for commercial aircraft.<sup>74</sup> Analysts noted that this balance between commercial aircraft, defense, and space “should smooth out the [demand] swings and reduce future volatility.”<sup>75</sup> It was also noted that Boeing could use commercial “offsets” to bolster its international sales of military hardware.<sup>76</sup>

Soon after the merger announcement, complaints began to be heard from Airbus. In February 1997, the chairman of Daimler-

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Questions, WASH. POST, Aug. 31, 1994, at F1; see also Mark Shwartz, Note, *The Not-So-New Antitrust Environment for Consolidation in the Defense Industry: The Martin Marietta-Lockheed Merger*, 1996 COLUM. BUS. L. REV. 329, 331 (1996) (discussing Lockheed-Martin and E-systems/Raytheon mergers).

<sup>71</sup> See John Mintz, *Raytheon to Acquire E-Systems*, WASH. POST, Apr. 4, 1995, at D1.

<sup>72</sup> See *Rockwell International Corp.: Shareholders Approve Sale of Businesses to Boeing*, WALL ST. J., Dec. 5, 1996. This merger wave was abruptly halted in 1998 when Lockheed-Martin's attempt to acquire Northrop Grumman was blocked by the Department of Justice. See *Lockheed Terminates Northrop Merger*, WALL ST. J., July 17, 1998, at A3.

<sup>73</sup> See John Mintz, *From King of the Skies to Subcontractor: Douglas Aircraft's Deal With Longtime Rival Boeing Signals Depth of Pioneer's Troubles*, WASH. POST, Dec. 8, 1996, at H1; John Mintz, *McDonnell Douglas May Become Boeing Supplier*, WASH. POST, Nov. 30, 1996, at C1.

<sup>74</sup> See Anthony L. Velocci, Jr., *U.S. Industry Poised for Further Realignment*, AVIATION WK. AND SPACE TECH., Dec. 23, 1996, at 10 (1996); Enter McBoeing, THE ECONOMIST, Dec. 21, 1996, at 89.

<sup>75</sup> Michele Kayal, *Boeing Purchase Gets U.S. Blessing: Merger Faces Tougher Test with EU Officials in the Wings.*, J. COMM., July 2, 1997, at 4.

<sup>76</sup> See *id.*

Benz Aerospace (an Airbus partner) complained that a Northrop Gunman ("Northrop") major aircraft/defense company had decided not to participate as a risk-sharer in the Airbus A3XX program because of pressure from Boeing and MDC on their U.S. suppliers, including Northrop.<sup>77</sup> Airbus' anger and EU opposition to the merger became more pronounced after three exclusive supply arrangements were signed by Boeing with major U.S. airlines between November 1996 and June 1997.<sup>78</sup>

The FTC took U.S. antitrust authority for reviewing the Boeing/MDC merger.<sup>79</sup> After a lengthy investigation, the FTC decided not to challenge the merger and published a brief explanatory letter on July 1, 1997.<sup>80</sup> In Europe, the Boeing/MDC merger met the threshold criteria, subjecting it to European Commission jurisdiction, and DG IV undertook an extensive investigation.<sup>81</sup> On July 4, 1997, a fifteen member advisory panel,

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<sup>77</sup> See Pierre Sparaco, *High Capacity Transport Critical to Airbus Plan*, AVIATION WK & SPACE TECH., Feb. 24, 1997, at 32.

<sup>78</sup> See Pierre Sparaco, *Airbus Fights Back in U.S.-Europe Rivalry*, AVIATION WK & SPACE TECH., June 23, 1997, at 20; see also *infra* Section 2.4.

<sup>79</sup> The FTC and DOJ have adopted "Clearance Procedures" that they use in order to decide which agency will be responsible for reviewing a merger. See James F. Rill, *Antitrust Enforcement: Department of Justice, FTC, State Attorneys General and Private Parties*, in 35TH ANNUAL ANTITRUST LAW INSTITUTE, 909, 967-68 (PLI Corp. Law & Practice Course Handbook Series No. B-846, 1994). Usually, the agencies attempt to make this decision within ten days of the merger being filed with the agencies. The key issue in the decision is which agency has the most expertise in the product area involved, presumably having been gained through a substantial recent antitrust investigation in the industry. Ongoing agency contacts with the involved parties due to another investigation are also considered relevant. See *id.* It has been reported that an extensive political battle over who would review the Boeing/MDC merger preceded the decision to award authority to the FTC. See Federal Regulators Compete On Mergers, FTC Takes Boeing-McDonnell Douglas Deal, SEATTLE POST-INTELLIGENCER, Jan. 8, 1997, at B8. It is perhaps not surprising that the FTC won this battle given that the FTC had been handling Boeing's previously announced combination with Rockwell's defense businesses. See, e.g., Polly Lane, *Politicians Favor Boeing, McDonnell Douglas Deal—Antitrust Concerns Are Largest Obstacle to Approval of Proposed Acquisition*, SEATTLE TIMES, Dec. 17, 1996, at A1.

<sup>80</sup> See Statement of Chairman Robert Pitofsky and Commissioners Janet D. Steiger, Roscoe B. Stark III, and Christine A. Varney, 5 TRADE REG. REP. (CCH), ¶ 24, 295, at 24, 123 (July 1, 1997) [hereinafter FTC Majority's July 1 Statement].

<sup>81</sup> See Commission Decision IV/M.877 of 30 July 1997, Declaring a Concentration Compatible with the Common Market and the Functioning of the EEA Agreement, 1997 O.J. (L 336) 16, ¶ 2 [hereinafter EU Commission's Boeing Decision].



consisting of the chiefs of member states' antitrust enforcement agencies, unanimously recommended that the European Commission block the merger—a stance for which Van Miert, who had repeatedly expressed his opposition to the proposed merger, quickly attained Commission support.<sup>82</sup> A heated war of words followed, during which President Clinton threatened trade sanctions against the European Union in the event that the merger was blocked.<sup>83</sup> Tension was extremely high, and as late as one day before the Commission's scheduled meeting of July 23, 1997, Van Miert claimed that the Commission would block the merger.<sup>84</sup> Finally, after Boeing made various last minute concessions, a settlement was reached, and the Commission agreed to approve the merger at its July 23 meeting, subject to the "undertakings" to which Boeing had agreed.<sup>85</sup>

## 2. THREE AREAS OF DISAGREEMENT

A number of interesting and unresolved antitrust issues were placed squarely at the forefront by the Boeing/MDC merger. The merger unquestionably strengthened Boeing's position in the commercial aircraft market, but U.S. authorities were more concerned with the inability of McDonnell-Douglas' commercial aircraft unit to compete effectively in the future and have any impact on prices.<sup>86</sup> This general difference in focus resulted from a few contrasting philosophies and economic assumptions embodied in U.S. and EU law, which included the following: (i) U.S. law expresses a greater concern for the likelihood of oligopolist pricing in a concentrated market than does EU law; (ii) U.S. law places more emphasis on improving consumer and social welfare, whereas EU law allows for the consideration of certain non-economic interests that are harmed by significant economic concentrations; (iii) EU law assumes a higher likelihood

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<sup>82</sup> See Anne Swardson, *EU Panel Urges Rejection of Boeing-McDonnell Merger*, WASH. POST, July 5, 1997, at F9; Julie Wolf, *Boeing-McDonnell Merger Plan Is Closer to Rejection in Europe*, WALL ST. J., July 16, 1997, at B4.

<sup>83</sup> See Brian Coleman, *Clinton Hints U.S. May Retaliate if EU Tries to Block Boeing-McDonnell Deal*, WALL. ST. J., July 18, 1997, at A2.

<sup>84</sup> See *Peace in Our Time: Boeing v. Airbus*, *supra* note 54, at 59.

<sup>85</sup> See *id.*

<sup>86</sup> See *supra* Section 1.2. As discussed previously, this generality regarding U.S. and EU competition law is now generally accepted by scholarly commentators and members of the FTC. See, e.g., Fox, *supra* note 1.

of a market leader achieving and exerting significant market power than does U.S. law; and (iv) U.S. law finds it much more probable than EU law that merger-created efficiency gains in the market leader will increase overall consumer (and/or societal) wealth. These differences, among others, resulted in each enforcement body analyzing various aspects of the Boeing/MDC merger very differently.

These contrasting philosophies and assumptions led to at least three major areas where the U.S. and EU law had contrasting views of the same aspects of the proposed Boeing/MDC merger: (1) the "competitive potential" of MDC and the likely exit of DAC absent the merger; (2) the significance of the enormous efficiencies that were expected to be generated by the merger; and (3) the importance and relevance of the exclusive supply contracts previously entered into by Boeing and three major U.S. airlines. First, U.S. authorities, placing great emphasis on MDC's pre-merger inability to compete, found little relevant difference between MDC leaving the commercial aircraft market or being joined with Boeing—the number of competitors would still be reduced to two. The European Union, however, found more relevance in the extent to which, post-merger, MDC's competitive potential could significantly contribute to Boeing's, enabling it to enhance its market dominance. Second, whereas U.S. law would view positively any efficiencies created by a merger which could result in lower prices for consumers (and rationalize resource allocation in the commercial aircraft and defense industries), the European Union viewed these cost-savings as enabling Boeing to strengthen its dominance in a market increasingly characterized by imperfect competition. Furthermore, the European Union doubted that any cost savings would benefit consumers in the long run. Third, whereas the United States found the exclusive dealing arrangements to be only slightly troubling, and unrelated to the analysis of the effect of the merger on overall market structure, the EU feared that these arrangements, especially when combined with the merger, would greatly contribute to Boeing's ability to maintain and strengthen its dominant position in the commercial aircraft market. This article will discuss each of these three areas in depth after an initial summary of the concerns raised by the Boeing/MDC merger at the most basic level.

2.1. *The Prima Facie Case Against the Boeing/McDonnell-Douglas Merger*

The most basic level of merger analysis is a simple estimate of the merging firms' market shares and overall market concentration. Much has been written in the United States on what level of market share or market concentration is too high, and enforcement policies over time have varied.<sup>87</sup> One particularly well known U.S. standard was announced in the *Alcoa* case, which states: to constitute monopoly under Section 2 of the Sherman Act, over 90% market share is "enough," 33% "certainly . . . is not," and "sixty to sixty-four percent" is "doubtful."<sup>88</sup> Of course, merger law acts to prevent monopoly formation in its earlier stages and thus might be expected to frown upon mergers creating even significantly smaller shares. Because of the generally high market concentration in the commercial aircraft market, and the very high market share of Boeing in particular, a deep analysis of this issue is unnecessary for the purposes of this article. The Boeing/MDC merger would be expected to raise antitrust concerns under virtually any standard. However, a brief summary of the modern decision-making processes of the enforcement bodies will suffice to give a general understanding of current U.S. procedure for challenging horizontal mergers and how it compares with the European standard.

Pursuant to the 1992 Horizontal Merger Guidelines, the U.S. enforcement bodies use the Herfindahl-Hirschman Index ("HHI") to assess the concentration in the market.<sup>89</sup> The HHI takes the squares of the firms' market shares and adds them together, effectively giving higher weight to the larger market shares. The intent is to have the index reflect the leading roles that very large firms play in an exercise of market power.<sup>90</sup> The Guidelines divide postmerger HHI market concentration figures into three categories: unconcentrated (less than 1000 HHI), moderately concentrated (between 1000 and 1800 HHI), and highly

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<sup>87</sup> See Pitofsky, *Proposals*, *supra* note 22, at 200-05 (briefly summarizing the debate).

<sup>88</sup> *United States v. Aluminum Co. of America*, 148 F.2d 416, 424 (2d Cir. 1945).

<sup>89</sup> See Horizontal Merger Guidelines, *supra* note 10, § 1.5.

<sup>90</sup> See Garick, *supra* note 2, at 317.

concentrated (over 1800 HHI).<sup>91</sup> In unconcentrated markets, the enforcement bodies are unlikely to challenge the merger.<sup>92</sup> In moderately or highly concentrated markets, the enforcement bodies will engage in a second calculation in order to determine the amount by which the merger raises the HHI.<sup>93</sup> An increase of more than 100 points in a moderately concentrated market, or an increase of more than 50 points in a highly concentrated market, will lead the enforcement bodies to consider the merger as raising serious anti-competitive concerns.<sup>94</sup>

In cases with very high market shares, even tiny mergers can lead the enforcement bodies to challenge the merger. For example, if one firm has a market share of 60%, this already raises the HHI to at least 3600. Adding a single percentage point to the 60% will result in an increase of 121 points.<sup>95</sup> In fact, in a highly concentrated market, the HHI test indicates that adding a 1% market share to any market share over 25% will exceed the fifty point threshold. However, even post-merger market shares of up to 42%<sup>96</sup> can theoretically avoid challenges under certain conditions.

Under EU law, a precondition to merger-enforcement is the finding of a "dominant position" on the part of a merging company, or the likelihood of such a company being created by the merger. Exactly what levels of market share constitute a dominant position may vary, but they appear to be significantly lower than the corresponding levels that would give rise to concern in the United States. One recent Article 86 case found a 50% market share to be *prima facie* evidence of dominance.<sup>97</sup> In a 1993 merger case involving Du Pont and Imperial Chemical Industries ("ICI"), the Commission alleged dominance in product

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<sup>91</sup> See Horizontal Merger Guidelines, *supra* note 10, § 1.5.

<sup>92</sup> See *id.* § 1.51.

<sup>93</sup> See *id.*

<sup>94</sup> See *id.*

<sup>95</sup> 61 squared is 3721.

<sup>96</sup> 42 squared is 1764, which is still below 1800.

<sup>97</sup> See Case C-62/86, *AKZO Chemie BV v. Commission*, 1991 E.C.R. I-3359, I-3360. But some commentators have characterized this case as a significant departure from prior case law. See, e.g., Jonathan Smith, *Abuse of Dominant Position: Predatory Pricing: AKZO Chemie BV v. Commission*, 12 EUR. COMPETITION L. REV. 205, 208-09 (1991).

markets where the combined market share was 43%.<sup>98</sup> However, most cases in which the European Commission has challenged a merger involved market shares “significantly higher than 43%.”<sup>99</sup> Indeed, the preamble of the Merger Regulation sets forth a presumption that a merger is compatible with the common market, and thus permissible, when the combined market share of the merged firms is less than 25%.<sup>100</sup>

Some commentators, in the context of comparing U.S. enforcement of Section 2 of the Sherman Act to EU enforcement of Article 86, believe that “[t]he difference is that EU authorities satisfy themselves that dominance exists on the basis of market shares that tend to be lower.”<sup>101</sup> If evidence from Article 86 cases are any guide, the European Union tends to draw “comparatively narrow markets and assert the existence of monopoly power within such markets on the basis of market shares or other indicia of power” that could escape such a classification by U.S. authorities.<sup>102</sup> Some commentators, however, have noted slightly more reluctance to declare a dominant position in cases under the Merger Regulation, where the consequences are often automatic, as compared to Article 86, where a subsequent abuse needs to be shown before legal action is taken.<sup>103</sup>

A *prima facie* case that proves that the Boeing/MDC merger raises serious anti-competitive issues is clear under virtually any standard. In an analysis based purely on the current market share, the Boeing/MDC merger easily qualifies as *prima facie* anticompetitive under the applicable U.S. and EU tests. Chairman Pitofsky stated:

[a]s many have noted, the proposed merger on its face did appear to raise serious antitrust concerns in connection with the commercial aircraft sector because Boeing accounts for roughly 60% of the sales of large commercial

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<sup>98</sup> See Commission Decision TV/M214 of 30 September 1992, Declaring the Compatibility of a Concentration with the Common Market, 93/9/EEC, 1993 O.J. (L 7) 13, 20, ¶ 32.

<sup>99</sup> Opi, *supra* note 31, at 274.

<sup>100</sup> See EU Merger Regulation, *supra* note 6, at 15.

<sup>101</sup> Jebsen & Stevens, *supra* note 19, at 479.

<sup>102</sup> *Id.* at 462.

<sup>103</sup> See, e.g., Opi, *supra* note 31, at 274.

aircraft and McDonnell Douglas, while its market share was slightly below 5% was a non-failing direct competitor.<sup>104</sup>

The FTC's July 1 statement itself admitted that "[o]n its face, the proposed merger appears to raise serious antitrust concerns."<sup>105</sup> The European Commission agreed.<sup>106</sup>

## 2.2. *The Strength (or Weakness) of McDonnell-Douglas' Commercial Aircraft Business*

### 2.2.1. *Background U.S. Law*

U.S. law recognizes that a *prima facie* case based on market structure and current market shares may be misleading if particular factors about the market and/or the acquired firm are true. One common example, although *not* applicable to the Boeing/MDC merger, is that of ease of market entry—i.e., that there is likely to be significant market entry that will quickly challenge the market share of the newly-merged firm.<sup>107</sup> Another example where current market share data needs to be modified to reflect market realities, which is very relevant to the Boeing/MDC merger, is where the current market share of one firm (often the acquired firm) over-represents that firm's future competitive significance. This idea is embodied in at least two separate doctrines in merger analysis: the *General Dynamics* doctrine and the "failing company" defense.

In 1974, in *United States v. General Dynamics Corp.*,<sup>108</sup> the Supreme Court stated that the statistical data about the market and market shares relied upon by the government were "not conclusive indicators of anticompetitive effects . . . . [O]nly a further examination of the particular market—its structure, history, and probable future—can provide the appropriate setting

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<sup>104</sup> Pitofsky, Staples Speech, *supra* note 42.

<sup>105</sup> FTC Majority's July 1 Statement, *supra* note 80.

<sup>106</sup> See EU Commission's Boeing Decision, *supra* note 81, ¶ 37, at 21.

<sup>107</sup> See Horizontal Merger Guidelines, *supra* note 10, § 3.11. The commercial aircraft market is generally considered to have extremely high barriers to entry.

<sup>108</sup> *United States v. General Dynamics Corp.*, 415 U.S. 486, 498 (1974).

for judging the probably anti-competitive effect of the merger.”<sup>109</sup> The message was that the traditional methods of measuring the likely anti-competitive effects of a merger—the same ones that are used today—ignore some factors which, when relevant, can cause the *prima facie* analysis to significantly overestimate or underestimate the anti-competitive risk of a merger. In the *General Dynamics* case itself, for instance, the Court looked at the ability of the acquired firm to acquire further coal reserves, which it viewed as more accurately reflecting the future competitive potential of the merging parties than did current market shares.<sup>110</sup>

The so-called *General Dynamics* doctrine has become widely accepted in U.S. law, and current judicial opinions continue to invoke it.<sup>111</sup> In a 1991 case, the Eleventh Circuit summarized the current understanding of the doctrine:

[A] defendant may rebut the government’s *prima facie* case by showing that the government’s market share statistics overstate the acquired firm’s ability to compete in the future and that, discounting the acquired firm’s market share to take this into account, the merger would not substantially lessen competition. The weakness of the acquired firm is only relevant if the defendant demonstrates that this weakness undermines the predictive value of the government’s market share statistics.<sup>112</sup>

The extent to which this doctrine can be used is illustrated by another recent decision, which cited *General Dynamics* in approving a merger between manufacturers which created a firm with a market share of 76% in an already highly concentrated market.<sup>113</sup>

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<sup>109</sup> *Id.* at 498 (quoting *Brown Shoe Co. v. United States*, 370 U.S. 294, 322 n. 38 (1962)).

<sup>110</sup> See *id.* at 502-03 (finding that the acquired firm’s current market share significantly overestimated its competitive significance).

<sup>111</sup> See, e.g., *Olin Corp. v. FTC*, 986 F.2d 1295, 1304 (9th Cir. 1993); *R.C. Bigelow, Inc. v. Unilever N.V.*, 867 F.2d 102, 108 (2d Cir. 1989).

<sup>112</sup> *FTC v. University Health, Inc.*, 938 F.2d 1206, 1221 (11th Cir. 1991); 4 PHILLIP AREEDA & DONALD F. TURNER, *ANTITRUST LAW* ¶ 935b, at 140-41 (1980).

<sup>113</sup> See *United States v. Baker Hughes Inc.*, 908 F.2d 981, 983 n. 3, 986 (D.C. Cir. 1990) (opinion written by Clarence Thomas and joined by Ruth

The antitrust enforcement bodies have recognized the *General Dynamics* doctrine in their Horizontal Merger Guidelines, stating that "recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance."<sup>114</sup> In sum, it appears that there is substantial room for a defendant in a merger case to cite factors with respect to the market or the acquired firm that illustrate that the merger will not have the negative effects contemplated by the Clayton Act.

A more absolute defense to merger enforcement under U.S. law, although extremely difficult to prove, is the failing firm defense. This defense is derived from the U.S. Supreme Court decisions of *International Shoe*<sup>115</sup> and *Citizen Publishing Co.*<sup>116</sup> These cases required that a firm demonstrate three facts in order to successfully invoke the defense: (1) that the firm is in imminent danger of financial failure, (2) that the allegedly failing firm would be unable to reorganize under the bankruptcy laws, and (3) that a good faith attempt to sell the firm to an alternative buyer was made, but was unsuccessful.<sup>117</sup>

The U.S. antitrust enforcement bodies have also adopted this doctrine. The 1992 Horizontal Merger Guidelines state that a merger is unlikely to create or enhance market power or facilitate exercise thereof, if "[imminent failure] of one of the merging firms would cause the assets of that firm to exit the relevant market. In such circumstances, post-merger performance in the relevant market may be no worse than market performance had the merger been blocked and the assets left the market."<sup>118</sup>

The Horizontal Merger Guidelines have four strict requirements necessary to successfully invoke the defense which include the three criteria mentioned in *International Shoe* and

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Bader Ginsburg—both now U.S. Supreme Court Justices). The market in this case had an HHI of 4303, far above the 1800 considered "highly concentrated" by the Merger Guidelines. See *id.* at 983 n.3.

<sup>114</sup> Horizontal Merger Guidelines, *supra* note 10, § 1.521.

<sup>115</sup> *International Shoe Co. v. FTC*, 280 U.S. 291 (1930).

<sup>116</sup> *Citizen Publishing Co. v. United States*, 394 U.S. 131 (1969).

<sup>117</sup> See *International Shoe*, 280 U.S. at 302-03; *Citizen Publishing Co.*, 394 U.S. at 138.

<sup>118</sup> Horizontal Merger Guidelines, *supra* note 10, § 5.0.



*Citizen Publishing* and, absent the acquisition, the assets of the failing firm would exit the relevant market.<sup>119</sup>

The purpose of the failing firm defense has been the subject of some debate. Some claim that the defense is at least partially intended to protect the “private interests” in the failing firm, “because of concern that shareholders, creditors, and communities not suffer unnecessary injury.”<sup>120</sup> Supporters of this rationale would be able to invoke the defense without coming to the conclusion that the acquisition was not anticompetitive. Support for this view generally comes from the language of the older judicial opinions.<sup>121</sup> A second rationale for the “failing firm” defense, more akin to the *General Dynamics* doctrine, holds that when a firm is failing financially and will not compete in the future, its acquisition by a competitor will not substantially lessen competition any more than the firm’s failure would have.<sup>122</sup> Supporters of this rationale are presumably focusing on cartel-facilitation and market-wide responsiveness to consumer interests, both of which are very dependent on the number of competitors in the market (which remains unaffected by the acquisition of a failing competitor). It is clear, however, that the acquisition of a failing competitor can, in many instances, contribute to monopoly-creation and the strengthening of the market position of the acquiring firm.<sup>123</sup> Still, the 1992 Merger Guidelines focus on the second economic rationale.<sup>124</sup>

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<sup>119</sup> See *id.*, *supra* note 10, § 5.1.

<sup>120</sup> Pitofsky, *Proposals*, *supra* note 22, at 231 (citing PHILLIP AREEDA & DONALD F. TURNER, *ANTITRUST LAW* (1978) (noting that the legislative history of the Clayton Act recognizes the interests of shareholders and other private interests in merging firms)).

<sup>121</sup> See, e.g., *United States v. Philadelphia Nat’l Bank*, 374 U.S. 321, 372 n. 46 (1963) (stating, “[t]hus, arguably, the so-called failing-company defense . . . might have somewhat larger contours as applied to bank mergers because of the greater public impact of a bank failure compared with ordinary business failures.”).

<sup>122</sup> See, e.g., Troy Paredes, Note, *Turning the Failing Firm Defense Into a Success: A Proposal to Revise the Horizontal Merger Guidelines*, 13 *YALE J. ON REG.* 347, 362 (1996) (describing this view as the “economic rationale” view).

<sup>123</sup> Pitofsky himself concedes the point in his 1992 article. See Pitofsky, *Proposals*, *supra* note 22, at 231; *infra* text accompanying notes 352-53; see also *infra* text accompanying notes 180-202 (discussing how the acquisition of MDC could contribute to Boeing’s dominance of the commercial aircraft market).

<sup>124</sup> See Horizontal Merger Guidelines, *supra* note 10, § 5.

### 2.2.2. *Background EU Law*

EU merger law leaves less room than United States law for the possibility that current market share will overstate actual market power. The case of *Aerospatiale-Alenia/de Havilland*<sup>125</sup> illustrates the Commission's preference for current market share as a measure of future ability to compete that is not as easy to manipulate. In that case, the Commission was reviewing a proposed acquisition of de Havilland, a Canadian subsidiary of Boeing, by ATR, a joint-venture aircraft company comprised of commuter aircraft manufacturers from France and Italy.<sup>126</sup> The parties proposing the merger attempted to convince the Commission to include options for future purchases in its market share analysis.<sup>127</sup> At issue was the reliability of the options for indicating future purchases. The technical performance of the planes in the marketplace was usually the driving factor in the successful conversion of options into firm orders. Although much historical data was available, the Commission concluded that the market and applicable technology was changing too quickly for an adequate estimate of the importance of option, and relied instead on market share figures based on firm orders to date.<sup>128</sup> The *de Havilland* case may demonstrate that the European Commission has been less flexible than the U.S. authorities in relying on softer variables to re-characterize market share. Nevertheless, the Commission was willing to entertain this argument at some length, which could demonstrate receptability to the argument.

Market share data that results in a finding of a "dominant position" does not end the legal inquiry. Although the text of the European Merger Regulation disallows a merger that "creates or strengthens a dominant position," this is followed by the phrase "as a result of which effective competition would be significantly impeded in the common market."<sup>129</sup> The Commission has used this "significant impediment" test to add some flexibility in the merger analysis and to determine whether this strengthening of a

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<sup>125</sup> See *de Havilland*, *supra* note 19, at 1991 O.J. (L 334) 42, 4 C.M.L.R. M2.

<sup>126</sup> See *id.*; Griffin & Sharp, *supra* note 31, at 669.

<sup>127</sup> See Garick, *supra* note 2, at 312.

<sup>128</sup> See *id.* at 312, 313.

<sup>129</sup> EU Merger Regulation, *supra* note 6, at 17.

dominant position actually will have an impact upon the relevant markets.<sup>130</sup>

In *de Havilland*, where the Commission held its first real discussion of the “significant impediment” test, the Commission stated that the relevant factors would primarily be: (1) the potential for quick, new market entry by competitors; (2) the ability of the proposed merger to contribute to technical and economic progress; and (3) the potential market disturbances caused by the merger.<sup>131</sup> The first requirement partly mirrors a similar consideration under U.S. law, permitting the creation of large market shares that will likely be eroded by subsequent entry, thereby eliminating the negative structural effects of the merger.<sup>132</sup> A demonstration of low barriers to entry and/or imminent entry can therefore avoid a Commission decision to block a merger. One case, citing ease of entry, permitted a merger creating a market share of over 90%.<sup>133</sup>

The other two factors of the significant impediment test, as identified by the Commission in *de Havilland*, were much less influential. The Commission used an extraordinarily limited definition of the “technical and economic progress” factor, limiting it to the consideration of possible cost savings—which the Commission found to be insignificant.<sup>134</sup> Further limiting the importance of even cost considerations, the Commission found it important that any cost savings were unlikely to be passed on to consumers in the long run.<sup>135</sup> With respect to the third requirement, that “[a] certain amount of market disturbance needs to be foreseen before a concentration creating or strengthening a dominant position becomes incompatible under article 2(3),”<sup>136</sup>

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<sup>130</sup> See Timothy J. Dorsey, *The European Community Merger Regulation: Questions Answered, Uncertainties Remain*, 8 TUL. EUR. & CIV. L.F. 95, 111 (1993).

<sup>131</sup> See *id.* at 135-38 (discussing the “significant impediment” test laid forth by the commission in *de Havilland*, *supra* note 19).

<sup>132</sup> See *de Havilland*, *supra* note 19, 1991 O.J. (L334) at 56, 4 C.M.L.R. at M27 (“[I]f there exists strong evidence that this position is only temporary and would be quickly eroded . . . with such market entry the dominant position is not likely to significantly impede effective competition . . .”).

<sup>133</sup> See Commission Decision, 91/535, Declaring the Compatibility With the Common Market of a Concentration, Case No. IV/M068—Tetra Pak/Alfa-Laval, 1991 O.J. (L 290) 35; Common Mkt. Rep. (CCH) [1991] 2 CEC 2203.

<sup>134</sup> See *infra* Section 2.3. See, e.g., *infra* text accompanying notes 230-37.

<sup>135</sup> See Dorsey, *supra* note 130, at 137 (citing *de Havilland*, *supra* note 19).

<sup>136</sup> *Id.* at 111-12.

the Commission demonstrated the difficulty facing a merging company that has been found to possess a dominant position. The Commission found a mere hypothetical possibility that a price war could ensue and drive the merged company's rivals out of the market, to be sufficient evidence of a market disturbance so as to require a finding that competition would be significantly impeded by the merger.<sup>137</sup>

The analysis in *de Havilland* suggests that the "significant impediment" test has not yet been given much substantive bite.<sup>138</sup> Sir Leon Brittan, Van Miert's predecessor as Competition Minister, further supported this view when he stated, "You may ask whether a dominant position without the effect of impeding competition is at all conceivable. I think that in most cases it is not."<sup>139</sup>

The existence of a meaningful "failing firm" defense in EU merger law is open to question. The Merger Regulation itself does not address the issue,<sup>140</sup> and the argument has come up in only two cases of which the author is aware.<sup>141</sup> In *Kali+Salz/MdK/Treuhand*,<sup>142</sup> the Commission relied on a "failing firm" rationale to approve the merger of the only two German potash producers, which left a monopoly in the German market and only two significant producers in all of Western Europe.<sup>143</sup> The Commission required a showing that: (1) the acquired firm would soon exit the market; (2) there was no less anti-competitive purchaser; and (3) the acquiring firm *would have taken over the market share of the acquired firm* even absent the merger.<sup>144</sup> This is the only case where the defense was raised successfully.

The second EU case involving "failing firm" considerations was *de Havilland*, and involved an attempt to raise a "failing division" defense. The permissibility of using this defense was

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<sup>137</sup> See *id.* at 137 (citing the *de Havilland* decision, *supra* note 19).

<sup>138</sup> See *id.*

<sup>139</sup> *Id.* at 112 (citing SIR LEON BRITTAN, COMPETITION POLICY AND MERGER CONTROL IN THE SINGLE EUROPEAN MARKET 36-37 (1991)).

<sup>140</sup> See HAWK & HUSER, *supra* note 27, at 269.

<sup>141</sup> See *id.* (stating information as of 1996).

<sup>142</sup> Commission Decision, Case No. IV.M308, *Kali & Salz/Mak/Treuhand*, 1994 O.J. (L186) 38.

<sup>143</sup> See HAWK & HUSER, *supra* note 27, at 269.

<sup>144</sup> See *id.* at 269. This third requirement seems extraordinarily difficult to satisfy.

not, and has still not been, reached by the Commission.<sup>145</sup> In *de Havilland*, the parties attempted to argue that, absent the merger, Boeing (the de Havilland division's parent) would merely phase out the de Havilland division and it would be eliminated as a competitor.<sup>146</sup> The Commission responded merely that "*without prejudice as to whether such a consideration is relevant* pursuant to Article 2 of the Merger Regulation, the Commission considers that such elimination is not probable."<sup>147</sup> In that case, the issue was easy to avoid, since there was some reason to doubt that de Havilland truly would have been phased out; in fact, there was a possibility that another competitor, British Aerospace, would be interested in purchasing the de Havilland division.<sup>148</sup>

### 2.2.3. *U.S. and EU Law Applied to the Boeing/MDC Merger*

The relevant market shares attributed to Boeing, MDC, and Airbus by the FTC were not made clear by the FTC's statement. The FTC concluded that Boeing accounted for "roughly 60% of the market."<sup>149</sup> The FTC did not provide a market share for McDonnell Douglas, but the statement of dissenting Commissioner Azcuenaga notes that MDC obtained 4% of the total orders in the relevant market for 1996.<sup>150</sup> Similarly, Chairman Pitofsky has stated publicly that he viewed the market share of MDC at just below 5%.<sup>151</sup> An HHI analysis based on these market shares reveals that the merger raised the market's HHI from 4912 to 5392, an increase of 480 points in an extremely concentrated market.<sup>152</sup> The Commissioners agreed that "[o]n its face, the proposed merger appears to raise serious antitrust concerns."<sup>153</sup> However, the FTC did not choose to challenge the

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<sup>145</sup> See *id.* at 270.

<sup>146</sup> See Garick, *supra* note 2, at 319.

<sup>147</sup> *Id.* (emphasis added).

<sup>148</sup> See *id.* at 320.

<sup>149</sup> FTC Majority's July 1 Statement, *supra* note 80.

<sup>150</sup> See Commissioner Mary Azcuenaga, Statement in *The Boeing Company*, File No. 971-0051 (available in <http://www.ftc.gov/opa/1997/9707/ma.htm>) [hereinafter Statement of Commissioner Azcuenaga].

<sup>151</sup> See Pitofsky, Staples Speech, *supra* note 42.

<sup>152</sup> Pre-merger market shares of 60, 36, and 4 result in an HHI of  $3600 + 1296 + 16 = 4912$ . Post-merger market shares of 64 and 36 result in an HHI of  $4096 + 1296 = 5392$ .

<sup>153</sup> FTC Majority's July 1 Statement, *supra* note 80.

merger, citing two reasons: "(1) McDonnell Douglas, looking into the future, no longer constitutes a meaningful competitive force in the commercial aircraft market[,] and (2) there is no economically plausible strategy that McDonnell Douglas could follow, either as a stand-alone concern or as part of another concern, that would change that grim prospect."<sup>154</sup> The reasoning cited by the FTC combines aspects of both the *General Dynamics* doctrine and the failing firm defense.

Although the majority did not cite the case by name, Commissioner Azcuenega asserted in her statement that the majority Commissioners relied "in their statement on the so-called *General Dynamics* defense, that is, that market shares based on past performance may overstate a firm's future competitive significance."<sup>155</sup> Furthermore, Chairman Pitofsky, in discussing the Boeing case, has cited the "teachings of *General Dynamics*—that future market potential is a critical factor rather than past market shares" as a basis for the FTC's decision.<sup>156</sup>

It takes persuasive evidence indeed to conclude that, despite the fact that McDonnell-Douglas was still receiving orders in 1996, and despite the fact that it was one of only three players in the market, DAC could exert no meaningful competitive force. However, the FTC believed that it did have some very powerful and persuasive evidence. It claimed that, after interviewing over forty airlines, "including almost every U.S. carrier, large and small, and many foreign carriers," the "virtually unanimous" testimony was that DAC was no longer a competitive force in the market for commercial aircraft, and that the "vast majority of airlines will no longer consider purchasing" aircraft from MDC.<sup>157</sup> The FTC elaborated that MDC's deteriorating position in the commercial aircraft market was due to its inability to invest in product lines, infrastructure, and research and development at rates comparable to Boeing and Airbus. The FTC also noted that MDC's product line did not offer common features which could create efficiencies for airlines by allowing interchangeability of spare parts and pilot training.<sup>158</sup>

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<sup>154</sup> *Id.*

<sup>155</sup> Statement of Commissioner Azcuenega, *supra* note 150.

<sup>156</sup> Pitofsky, Staples Speech, *supra* note 42.

<sup>157</sup> FTC Majority's July 1 Statement, *supra* note 80.

<sup>158</sup> *See id.*

The FTC's conclusion that DAC had no further ability to compete, and that there was no economically plausible strategy that DAC could follow in order to turn around the company, is reminiscent of a failing firm argument.<sup>159</sup> The FTC Commissioners, perhaps sensitive to this fact, explicitly stated that their decision not to challenge the proposed merger:

does not reflect a conclusion that McDonnell Douglas is a failing company or that Douglas Aircraft is a failing division . . . the failing company defense comes into play only where the Commission first finds that the transaction is likely to be anticompetitive . . . [but] Douglas Aircraft is no longer an effective competitor.<sup>160</sup>

The majority, in essence, contended in its opinion that the *General Dynamics* doctrine was sufficient to permit the merger to proceed.

Despite these statements by the majority, it remains possible (or even likely) that failing firm (or failing division) considerations played a role in the decision by the FTC to approve the Boeing/MDC merger. The FTC's opinion stated that DAC's assets were likely to remain on the market due to "a modest backlog of aircraft orders, [and that] it is unlikely that the aircraft division would have been liquidated quickly."<sup>161</sup> While this statement is framed as a concession that the failing firm (or failing division) defense is unavailable, the language would not necessarily imply that, under a more relaxed standard, failing firm considerations could not play a role in permitting the merger to proceed. A number of leading commentators, including Chairman Pitofsky himself, have suggested that antitrust enforcement could benefit from a significant extension of the failing firm defense to cases such as this one. For example, Pitofsky proposed in his 1992 article that the definition of a failing firm be widened to a firm that is likely to fail rather than a firm in an actual condition of failure.<sup>162</sup>

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<sup>159</sup> See *id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> See Pitofsky, *Proposals*, *supra* note 22, at 233.

In addition to the issue of the imminence of the firm's failure, Pitofsky's writings may be interpreted as stating that, in theory, he might even be willing to justify a slightly anti-competitive merger with a broader failing firm defense. In justifying his 1992 proposal, he explicitly invokes the "private interests" rationale:

Once it becomes clear that a company is inexorably going downhill, shareholders, creditors and workers will all profit if it can be sold before it is a financial basketcase . . . . The transfer of companies into stronger hands is called for all the more when those companies compete in foreign markets or face vigorous foreign competition in domestic markets.<sup>163</sup>

Pitofsky asserts that "the primary (*though perhaps not exclusive*) concern of antitrust must be to protect competition — not private interests. Thus, the sale of assets to a company outside the market is sure to be preferred to a sale to a large rival."<sup>164</sup> This statement, however, is not inconsistent with (and may even support) a conclusion that, should there be no outside party willing to buy a falling division, private interest considerations may justify a decision to permit a slightly anti-competitive merger of a firm or division that would likely fail absent the merger.

In sum, there appears to be some evidence supporting the conclusion that, under U.S. law and the *General Dynamics* doctrine, MDC's should be seen as having overstated the importance of its market share to competition, and Boeing's acquisition of MDC should not be considered anti-competitive. This conclusion may be reached in the context of U.S. law, which is relatively more concerned with the dangers of cartel facilitation than monopoly creation, and in light of the fact that the amount of competitors in the market would be reduced from three to two either way. However, due to the difficulties in law and in fact of concluding absolutely that the merger had zero anti-competitive effects, it is possible, and even likely, that broader "failing firm" (and possibly private interest) considerations played

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<sup>163</sup> *Id.* at 234.

<sup>164</sup> *Id.* at 231 (emphasis added).



some role in leading the FTC to approve a merger that may have had slight anti-competitive effects.

In computing the corresponding market shares of Boeing and MDC, the EU numbers were slightly higher than U.S. estimates. For instance, the European Union found that “backlog [order] data is widely seen as the best indicator of market position” in the market for commercial aircraft.<sup>165</sup> The European Union cited market shares of 64%, 30%, and 6% for Boeing, Airbus, and MDC respectively, using backlog data as of December 31, 1996.<sup>166</sup> The European Union then cited the average market shares of each company, based on backlog data, for the past ten years: 61%, 27%, and 12% for the three companies respectively.<sup>167</sup> The EU opinion goes on to discuss particular market shares in the wide-body and narrow-body segments of the market, and within the European Union itself, concluding that the patterns are “similar” and “more or less the same.”<sup>168</sup> Although the European Union does note that it has been provided information regarding market shares based on new firm orders<sup>169</sup> (the figures used by the FTC<sup>170</sup>), the opinion does not cite these figures.

The European Union’s comparatively larger focus on older and more certain market share data is consistent with its position in *de Havilland* and prior resistance to going as far as the U.S. authorities have taken the *General Dynamics* doctrine. The result, however, was market share figures assigning Boeing a total post-merger share of 70-73% (vs. about 65% for the FTC), in a merger-regulation regime already more sensitive to concerns of single firm dominance than the U.S. authorities were.<sup>171</sup> The European Commission reasoned from this data that there had recently been a gradual increase in the market share of Boeing, with a gradual decline of the market share of MDC, leaving Airbus’s share

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<sup>165</sup> EU Commission’s Boeing Decision, *supra* note 81, ¶ 28, at 20.

<sup>166</sup> *See id.* ¶ 29, at 20.

<sup>167</sup> *See id.* ¶ 31, at 21.

<sup>168</sup> *See id.* ¶ 33, at 21.

<sup>169</sup> *See id.* ¶ 28, at 20.

<sup>170</sup> It is not completely clear from the opinion that the FTC used these figures. The author draws this inference from the dissenting opinion of Commissioner Azcuenega in her discussion of the relevant market share of MDC. *See* Statement of Commissioner Azcuenega, *supra* note 150.

<sup>171</sup> *See* EU Commission’s Boeing Decision, *supra* note 81, ¶¶ 29-30, at 20.

remaining relatively constant.<sup>172</sup> The European Union viewed this evidence as strongly suggesting dominance, irrespective of whether this strength was obtained through better prices or product quality. Among the European Commission's conclusions from the relevant data, the following paragraph is illuminating on the Commission's focus:

The very high market shares of Boeing already indicate a strong position in the overall market for large commercial aircraft . . . . Furthermore, after making an inroad into Boeing's position in the 1980s, Airbus was not able significantly to improve its position during the 1990s whilst Boeing, already starting from a high level, was able to increase its market share more or less continuously during this period. This indicates that it was difficult for Airbus to attack Boeing's position in the market even after having gained a market share of nearly 30% in the 1980s. This is also reflected by the fact that Airbus has not succeeded in making a significant inroad in most of the top 10 operators' fleets . . . . The market power of Boeing, *allowing it to behave to an appreciable extent independently of its competitors, is an illustration of dominance, as defined by the [EC]* . . . .<sup>173</sup>

The EU opinion goes on to note other advantages that Boeing possesses in the commercial aircraft market. Boeing has the broadest customer base,<sup>174</sup> 60% of the current worldwide fleet in service (versus 24% for MDC, 14% for Airbus, and 2% for Lockheed),<sup>175</sup> a broader product range,<sup>176</sup> and cost savings arising from aircraft commonality benefits.<sup>177</sup> The opinion also notes the exclusive deals that had been signed by Boeing with three major

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<sup>172</sup> See *id.* ¶ 36, at 21.

<sup>173</sup> *Id.* ¶ 37, at 21(emphasis added).

<sup>174</sup> See *id.* ¶ 40, at 22.

<sup>175</sup> See *id.* ¶ 41, at 22.

<sup>176</sup> See *id.* ¶ 41, at 22-23. Boeing is the only producer of a 400+ passenger plane because Airbus currently produces no competitor to the Boeing 747-400. See *id.* ¶ 38, at 21-22 (table).

<sup>177</sup> See *id.*, ¶ 43, at 23.

airlines just prior to the merger.<sup>178</sup> The European Commission concluded that Boeing's position in the market for commercial aircraft was definitely dominant.<sup>179</sup>

The European Commission next analyzed how the acquisition of MDC would contribute to this dominant position. The Commission noted that the immediate effects would be that: (1) Boeing would increase its market share from 64% to 70%; (2) Boeing would reduce its future competitors from two to one; (3) Boeing would increase its customer base from 60% to 84% of the current fleet in service; (4) Boeing's production capacity would be increased, especially in terms of its skilled work force, and (5) Boeing's ability to induce airlines to enter into exclusive dealing arrangements would be increased, permitting it to foreclose much of the market to competition.<sup>180</sup> In comparison, it could be noted that only the second consideration pointed out by the European Union was considered by U.S. regulators in their analysis, and it was deemed irrelevant by the fact that, because DAC's future prospects were so dim, the two competitors would likely be reduced to one without the merger anyway.<sup>181</sup> In the European Commission's elaboration on the second point, it conceded that although MDC's past influence on the market was significant, its future prospects were indeed grim.<sup>182</sup> However, the Commission concluded that MDC's competitive potential—when added to Boeing's—would have a significant impact on the market.<sup>183</sup>

In its analysis of MDC's recent competitive significance, the Commission's information appeared to differ significantly from that of the FTC, leading the Commission to conclude that "the [recent] impact of MDC on the conditions of competition in the market for large commercial aircraft was *higher* than reflected by its market share in 1996."<sup>184</sup> First, the Commission noted that it had received information from thirty-one airlines which had purchased aircraft in the past five years. Twenty airlines stated that, in those cases where they had purchased aircraft from either Boeing or Airbus, MDC had been in competition for all or part of

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<sup>178</sup> See *id.*

<sup>179</sup> See *id.* ¶ 52, at 54.

<sup>180</sup> See *id.* ¶ 54, at 24.

<sup>181</sup> See *id.* ¶ 57, at 25.

<sup>182</sup> See *id.* ¶ 55, at 24.

<sup>183</sup> See *id.* ¶ 56, at 25.

<sup>184</sup> *Id.* ¶ 58, at 25 (emphasis added).

the orders. Furthermore, thirteen of those airlines stated that competition from MDC had resulted in the airline receiving better price or purchasing conditions—with nine airlines considering this influence to be at least “significant.”<sup>185</sup> The Commission further cited a study by Lexecon Ltd. done on behalf of Airbus that concluded that, of fifty-two competitions for supplying aircraft between 1994 and 1996, MDC’s presence led to a reduction of over 7% in the realized price in orders placed with Airbus.<sup>186</sup>

However, when the European Commission turned to analyzing MDC’s likely future performance, its conclusions were similar to that of the FTC. It noted that MDC received very few firm new orders in 1996, and lost most of its core customers in the previous nine months, creating the perception in the marketplace that DAC would have no further prospects in the market.<sup>187</sup> The European Commission thus conceded that “MDC is no longer a real force in the market for the sale of new aircraft on a stand-alone basis.”<sup>188</sup>

Unlike the FTC, however, the Commission then turned its focus to the effect that MDC’s competitive potential would have in the hands of Boeing. It noted that Boeing may decide to continue many of DAC’s product lines, because the negative market perception regarding MDC’s future competitive potential would be removed.<sup>189</sup> MDC aircraft could also be marketed along with Boeing aircraft.<sup>190</sup> The Commission noted that, as opposed to the relatively equal playing field between Airbus and Boeing for obtaining MDC customers that would have existed had MDC decided to phase out its production over time, Boeing would, in the event that the Boeing/MDC merger proceeded, have preferential access to MDC’s large customer base.<sup>191</sup> The Commission noted further that this preferential access would be exacerbated by Boeing’s position providing customer support and repair for MDC’s very substantial existing fleet in service.<sup>192</sup>

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<sup>185</sup> See *id.*

<sup>186</sup> See *id.*

<sup>187</sup> See *id.* ¶ 59, at 25.

<sup>188</sup> *Id.* ¶ 58 (ii), at 25 (emphasis added).

<sup>189</sup> See *id.* ¶ 61, at 61.

<sup>190</sup> See *id.*

<sup>191</sup> See *id.*

<sup>192</sup> See *id.* ¶¶ 62-64, at 26.

The European Union felt that prior precedent existed for this fear of Boeing using its influence unfairly against its customers. It cited an example of a letter from a Boeing executive sent to a Japanese aircraft company that had recently bought from Airbus:

I want you to know that the Boeing Company takes such a decision . . . extremely seriously. This not only comes as a shock to me and my colleagues here, but will surely have a negative impact on the future of the long-term relationship our two companies have enjoyed over many years . . . . More significantly, it could have undesirable implications for the Japan America aerospace industry cooperation.<sup>193</sup>

The European Commission also found it likely that Boeing could use its position to its advantage vis-a-vis its suppliers against Airbus. The opinion noted that 50% of the activities of an aircraft manufacturer are based on supplies from third parties.<sup>194</sup> By adding MDC's military and commercial contracts from many of these same suppliers, Boeing's buying power would be substantially increased.<sup>195</sup> In fact, many companies would now rely on the merged firm for over 50% of their sales, and the prospect of losing Boeing as a customer could potentially be ruinous for them.<sup>196</sup> The Commission concluded that the ability of Boeing to use this "monopoly power" to force competitors to give it preferential treatment over Airbus or to discourage their working with the consortium at all, would be significantly enhanced by the merger.<sup>197</sup>

The Commission felt that past practices had indicated a likelihood of Boeing using this power over suppliers. It claimed that Boeing's existing buying power may have negatively affected Airbus's attempts to find a risk-sharing partner for the A3XX.<sup>198</sup>

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<sup>193</sup> *Id.* ¶ 82 (quoting a letter from Ronald Woodard, Boeing Commercial Airline, Group President, to a Japanese Aircraft Leasing Company, Dec. 17, 1996).

<sup>194</sup> *See id.* ¶ 105, at 35.

<sup>195</sup> *See id.*

<sup>196</sup> *See id.*

<sup>197</sup> *See id.* ¶ 106, at 35.

<sup>198</sup> *See id.* ¶ 107, at 35.

The Commission noted that in early 1997, Northrop Grumman decided not to participate in the risk-sharing venture, and that following its refusal, it received a \$262 million subcontract to upgrade the AWACS radar by Boeing as prime contractor.<sup>199</sup> The Commission concluded that, "[i]n general, it seems likely that the increase in Boeing's buying power could significantly weaken the competitive position of Airbus and, in turn, strengthen the position of Boeing."<sup>200</sup>

Not surprisingly, the European Commission concluded from this analysis that the Boeing/MDC merger would indeed strengthen Boeing's dominant position in the worldwide commercial aircraft market. This conclusion was clear to the EU, even assuming that: (1) MDC had no future competitive significance in the market on a stand-alone basis;<sup>201</sup> (2) it was extremely unlikely that any third party would be interested in acquiring DAC; and (3) DAC would soon exit the market for commercial aircraft.<sup>202</sup>

The Commission did not apply a failing firm or failing division analysis or respond to any arguments made of that nature. In fact, the Commission strongly implied that DAC's exit would be preferable to the current merger under relevant EU law. This appears consistent with EU law in that: (1) failing firm arguments have very rarely succeeded; (2) the failing division defense has never even been addressed; and (3) the only successful use of the failing firm defense required a showing that the non-failing firm would have acquired all of the failing firm's market share even absent a merger.<sup>203</sup> The extensive analysis by the Commission of how Boeing could use the merger to raise its chances of acquiring MDC's present customer base would likely have been enough on its own to distinguish Boeing from the only successful failing firm case, *Kali+Salz/MdK/Treuhand*, had the Commission addressed the issue.

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<sup>199</sup> See *id.*

<sup>200</sup> *Id.* ¶ 108, at 35.

<sup>201</sup> See *id.* ¶ 58(ii), at 25.

<sup>202</sup> See *id.* ¶ 60, at 26. After having engaged in extensive market inquiries, the Commission noted that no party, besides Boeing, including Airbus and all of its partners, was interested in purchasing DAC. See *id.*

<sup>203</sup> See *supra* notes 142-44 and accompanying text (discussing the European Commission's decision in *Kali+Salz/MdK/Treuhand*).

#### 2.2.4. *In Sum*

It can thus be seen that the different philosophies, assumptions, and focuses of U.S. and EU law have led to profoundly different results. A concern with cartel-facilitation and the general lethargy and lack of responsiveness to consumer interests embodied in oligopoly, combined with skepticism regarding the likelihood of persistent monopoly power and single firm dominance, led U.S. authorities to conclude that it was indifferent concerning the two evils of MDC either leaving the market altogether or being merged with Boeing. A decision to approve the merger may have been further supported by the fact that the merger offered an opportunity to promote significant private interests by maintaining DAC as a going concern. However, a strong concern with monopoly creation and the consumer-indifference of a dominant firm led EU authorities to challenge a merger that it viewed as strongly contributing to the dominance of the market leader, and possibly permitting it to further erode its sole rival's market share.

#### 2.3. *Efficiencies Created by the Boeing/McDonnell-Douglas Merger*

There are at least three different ways to view any efficiencies created by the Boeing/MDC merger. One could conclude that (1) the efficiencies will strengthen Boeing's market power and contribute to its ability to act in an anti-competitive manner (negative view); (2) the efficiencies are irrelevant in determining whether the market is excessively concentrated and the merger will lead to anti-competitive results (neutral view); or (3) the large efficiencies are a countervailing consideration justifying some social welfare losses from anti-competitive activity (positive view). In general, a concern with monopoly creation and leading firm lethargy will lead to the more negative view, while a concern with cartel facilitation and market-wide consumer indifference, with a corresponding focus on market structure, will lead to the neutral view. A concern with maximizing social welfare might lead to the positive view, while a more focused concern with consumer welfare might lead to a mix of the neutral and positive views, depending on the likelihood that the efficiencies will be "passed on" to consumers in the form of lower prices or better quality goods.

### 2.3.1. *Relevant U.S. Law*

U.S. law has moved from a relatively neutral or negative view of merger efficiencies towards a more positive view—with the neutral view persisting at very high levels of concentration. Section 7 of the Clayton Act prohibits mergers whose effects “may be substantially to lessen competition, or to tend to create a monopoly.”<sup>204</sup> Despite the apparent ambiguity of this language regarding the relevance of efficiency considerations, early decisions by the Supreme Court interpreted the statute to forbid considerations of efficiency when assessing the impact of a merger on competitive conditions.<sup>205</sup> In the past twenty years, however, subsequent judicial decisions and new explicit determinations by the federal enforcement bodies have made it clear that demonstrated claims of efficiencies produced by a merger can have a very positive impact on a merger’s chances of being approved.

In *FTC v. Procter & Gamble Co.*, the U.S. Supreme Court stated that “[p]ossible economies cannot be used as a defense to illegality. Congress was aware that some mergers that lessen competition may also result in economies, but it struck the balance in favor of protecting competition.”<sup>206</sup> Additionally, in the earlier case of *United States v. Philadelphia National Bank*, the Court explicitly denied that balancing should be permitted, stating that an anti-competitive merger cannot be saved merely because “on some ultimate reckoning of social or economic debits and credits, it may be deemed beneficial.”<sup>207</sup>

However, current U.S. courts are much more hospitable to efficiency considerations. Despite the Supreme Court’s declaration in *Procter & Gamble*, Chairman Pitofsky has noted that Congress never specifically addressed the question of possible tradeoffs in the antitrust statutes between anti-competitive effects and likely efficiencies.<sup>208</sup> In fact, nothing in the language or legislative history of the antitrust statutes suggests that an efficiencies defense in the area of merger enforcement would be

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<sup>204</sup> 15 U.S.C. §18 (1999).

<sup>205</sup> See, e.g., *FTC v. Procter & Gamble Co.*, 386 U.S. 568 (1967).

<sup>206</sup> *Id.* at 580.

<sup>207</sup> *United States v. Phila. Nat’l Bank*, 374 U.S. 321, 371 (1963).

<sup>208</sup> See Pitofsky, *Proposals*, *supra* note 22, at 206.



inappropriate.<sup>209</sup> Furthermore, since the 1977 *Sylvania* decision, the Supreme Court has begun to seriously entertain claims of efficiency when assessing the competitive significance of various practices.<sup>210</sup> One commentator suggests that earlier decisions such as *Procter & Gamble* represent “a different era in antitrust, an era in which formalistic rules rather than economic reasoning ruled the day and efficiencies often were thought harmful.”<sup>211</sup> Although no merger case has reached the Supreme Court since *Sylvania*, a variety of lower courts have already begun finding ways to examine efficiency claims,<sup>212</sup> and it has been asserted that the current trend is toward regarding efficiency as a “plus factor” that could make the difference in a close case.<sup>213</sup>

U.S. antitrust enforcement authorities view positively any possible efficiencies generated by a merger because of the possibility of translating these efficiencies into lower costs for the firm’s customers.<sup>214</sup> The 1992 Horizontal Merger Guidelines explicitly recognize the importance of merger-generated efficiencies.<sup>215</sup> In addition, these Guidelines were reviewed and amended in 1996 to further support the idea that efficiencies will be considered positively.<sup>216</sup> The revised Guidelines state that “mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs in producing a given quantity and quality than either firm could have achieved without the proposed transaction.”<sup>217</sup> The Guidelines go on to state the Agencies’ policy that they will “not challenge a merger if cognizable efficiencies are of a character and magnitude such that

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<sup>209</sup> See *id.* at 211.

<sup>210</sup> See Joseph Kattan, *The Role of Efficiency Considerations in the Federal Trade Commission’s Antitrust Analysis*, 64 ANTITRUST L.J. 613, 617 (1996) (discussing *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977)).

<sup>211</sup> *Id.*

<sup>212</sup> See Pitofsky, *Proposals*, *supra* note 22, at 211.

<sup>213</sup> See Lao, *supra* note 67, at 379; see also *F.T.C. v. Univ. Health, Inc.*, 938 F.2d 1206 (11th Cir. 1991) (holding that a defendant is permitted to use merger-generated efficiencies to rebut the government’s *prima facie* case).

<sup>214</sup> See Horizontal Merger Guidelines, *supra* note 10, § 4.

<sup>215</sup> See *id.*

<sup>216</sup> See *id.*

<sup>217</sup> *Id.*

the merger is not likely to be anticompetitive in any relevant market."<sup>218</sup>

Proof of efficiencies will presumably be sufficient to save an otherwise anti-competitive merger if, in an apparent balancing test, they outweigh the likely anticompetitive dangers:

To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market . . . . The greater the potential adverse competitive effect of a merger . . . the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market . . . . In the Agency's experience, efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not great.<sup>219</sup>

A more concrete suggestion of when merger-generated efficiencies should justify an otherwise anti-competitive merger can be found in Pitofsky's 1992 article:

In any market where postmerger concentration is moderate, and the combined company after the merger would hold less than 35% of the market, a horizontal merger should be legal if the defendants can clearly support the claim that production efficiencies leading to a substantial reduction in unit costs will result and these efficiencies could not be achieved through a much less restrictive alternative.<sup>220</sup>

Pitofsky considered this proposal to be "conservative."<sup>221</sup>

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<sup>218</sup> *Id.*

<sup>219</sup> *Id.*

<sup>220</sup> Pitofsky, *Proposals*, *supra* note 22, at 218.

<sup>221</sup> *See id.*

The Agencies are less likely to view efficiencies as important in cases of extremely high market concentration. The current Horizontal Merger Guidelines state that “[e]fficiencies almost never justify a merger to monopoly or near-monopoly.”<sup>222</sup> Pitofsky’s 1992 proposal stated that if a firm “holds thirty-five percent or more of the market, and the acquired firm has any significant market position (*even two or three percent*), claims of efficiency should not protect an otherwise illegal merger even in a moderately concentrated market.”<sup>223</sup> The Agencies’ and Chairman Pitofsky’s views are that efficiency claims can be extremely important in evaluating a merger, but that mergers in highly concentrated markets will presumptively *not* be entitled to an efficiencies defense absent the acquired company’s having an extremely weak market position—such as less than 2-3% (this caveat, as the prior Section suggests, is highly relevant to the Boeing/MDC case).<sup>224</sup> An observer will note that the view that efficiencies become less relevant as market concentration goes up appears to be very consistent with: (1) a fear that gains from efficiency will be dominated by deadweight losses at high levels of market share or market concentration; and/or (2) the belief that the gains from efficiencies in imperfect markets will be confined to producers and not passed on to consumers.

In practice, the evidence supports the view that efficiency analysis can be an important factor in the Agencies’ decisions on whether to block a merger. One commentator claims that:

In the area of merger enforcement, the antitrust enforcement agencies have found the right balance by adjusting the core analysis of competitive effects to account indirectly for the enhanced likelihood that certain transactions are likely to bring about efficiencies . . . . In industries in which scale economies are significant, the agencies have routinely, and quite correctly, adjusted the numerical presumptions of the Horizontal Merger Guidelines . . . .<sup>225</sup>

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<sup>222</sup> Horizontal Merger Guidelines, *supra* note 10, § 4.

<sup>223</sup> Pitofsky, *Proposals*, *supra* note 22, at 219 (emphasis added).

<sup>224</sup> See *supra* Section 2.2.3.

<sup>225</sup> Kattan, *supra* note 210, at 614.

Empirical evidence also supports the view that, as suggested by the Merger Guidelines<sup>226</sup> and recommended in Pitofsky's 1992 article, the Agencies are less likely to challenge a merger in an industry where efficiencies are likely and market concentration is not.<sup>227</sup>

### 2.3.2. *EU Law on Merger Efficiencies*

The EU Merger Regulation has been interpreted to view merger-created efficiencies at least neutrally, and possibly negatively. This viewpoint is consistent with this article's earlier observation that EU law is relatively more concerned with monopoly creation, single-firm dominance, and the non-economic consequences of large, super-efficient, firms.<sup>228</sup> The EU Merger Regulation declares a merger to be incompatible with the common market if it "creates or strengthens a [dominant] position as a result of which effective competition would be significantly impeded in the common market or in a substantial part of it is significantly impeded."<sup>229</sup>

Although the Merger Regulation permits the Commission to consider whether the merger promotes "technical and economic progress,"<sup>230</sup> the evidence seems to indicate that the EU authorities do not interpret this clause to mean that an otherwise anti-competitive merger may be permitted because of efficiency considerations. In fact, the evidence suggests that the Commission disregards the value of efficiencies in evaluating mergers.<sup>231</sup> Sir Leon Brittan, the Commissioner responsible for competition policy at the time of the enactment of the Merger Regulation, has stated that "[i]n a competitive market, mergers may or may not give rise to technical and economic progress. In an uncompetitive market, even if they do, they will not be allowed."<sup>232</sup> It is likely that this position is based at least partly on

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<sup>226</sup> See Horizontal Merger Guidelines, *supra* note 10, at § 4.

<sup>227</sup> See Kattan, *supra* note 210, at 614 ("It is no accident that we seldom see a challenge of a defense industry merger, hospital merger, or software merger where four or more surviving competitors remain in the relevant market.").

<sup>228</sup> See *supra* Section 1.2 for additional discussion.

<sup>229</sup> EU Merger Regulation, *supra* note 6, at (L 257/15).

<sup>230</sup> *Id.*

<sup>231</sup> See, e.g., Opi, *supra* note 31, at 282.

<sup>232</sup> Griffin & Sharp, *supra* note 31, at 668 (citing Sir Leon Brittan, *The Law and Policy of Merger Control in the EEC*, 15 EUR. L. REV. 351, 353 (1990)).

the assumption that any economic benefit of the transaction would be “confined to the dominant company in the form of monopoly rents.”<sup>233</sup> Another commentator concludes that, although there are some cases where the Commission has suggested that efficiencies can be viewed procompetitively, for the moment, it appears that the Commission’s view is that a concentration which creates or strengthens a clearly dominant position for a single firm cannot be “saved” by a showing of economic efficiencies, regardless of how strong the showing may be.<sup>234</sup>

The discussion of efficiencies in the recent case *Aerospatiale-Alenia/de Havilland (de Havilland)*<sup>235</sup> further suggests that parties will not be permitted to justify an otherwise impermissible merger. ATR was the leading manufacturer of commuter aircraft, but acquisition of the Canadian company de Havilland would have given ATR a fuller line of aircraft and cost savings amounting to approximately 1/2% of annual turnover.<sup>236</sup> The Commission concluded that, not only were these cost savings insufficient to promote technical or economic progress, but even if they were, such progress would not lead to any benefits for consumers.<sup>237</sup> In short, because of the Commission’s focus on the dangers of monopoly creation and the importance of consumer welfare, the permissibility—and the wisdom—of considering efficiency claims in evaluating a merger was strongly rejected.

The evidence supports the view that not only has there been no “efficiency defense” under EU merger review law, but there may be an “efficiency attack.”<sup>238</sup> EU law, principally concerned with dominant firms—for economic and non-economic reasons—tends to focus on whether particular “advantages” will result for the merged firm—including, possibly, economic

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<sup>233</sup> *Id.* (citing Sir Leon Brittan, *The Law and Policy of Merger Control in the EEC*, 15 EUR. L. REV. 351, 353 (1990)). This issue is often referred to as whether efficiency gains are “passed on” to consumers.

<sup>234</sup> See HAWK & HUSER, *supra* note 27, at 269.

<sup>235</sup> See *supra* Section 2.2.2 (discussing the European Commission’s decision in *de Havilland*).

<sup>236</sup> See Griffin & Sharp, *supra* note 31, at 669.

<sup>237</sup> See *id.*

<sup>238</sup> See *id.* at 671 (citing Frederic Jenny, *EEC Merger Control: Economies as an Antitrust Defense or an Antitrust Attack?*, 1992 FORDHAM CORP. L. INST. 591, 597).

efficiencies.<sup>239</sup> Frederic Jenny, as a member of the French Competition Council, concluded that an examination of the relevant EU case law suggests that the Commission often considers mergers that contribute to economic efficiency to be more likely to create a dominant position:

The possibility that a merger might lead to static . . . [or] dynamic efficiency gains . . . which other nonmerging firms are unlikely to achieve is interpreted as *prima facie* evidence that the merger will enable the merging firms to acquire a dominant position incompatible with the common market.<sup>240</sup>

It should be noted that Jenny concluded that, although this approach is warranted by the applicable EU legislation, this position is unwise from a public policy standpoint.<sup>241</sup>

### 2.3.3. *The Differing Laws Applied to the Boeing/McDonnell-Douglas Merger*

Extraordinary efficiencies were expected to be generated by the Boeing/MDC merger. By most accounts, the primary purpose of Boeing's acquisition of MDC was to generate efficiencies from MDC's space and defense businesses.<sup>242</sup> In addition to this expectation, the combined company was expected to achieve a better balance between commercial and military work, making it less vulnerable to demand fluctuations in each volatile industry.<sup>243</sup> As this section will demonstrate, however,

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<sup>239</sup> See HAWK & HUSER, *supra* note 27, at 268.

<sup>240</sup> Griffin & Sharp, *supra* note 31, at 671 (citing Frederic Jenny, *EEC Merger Control: Economies as an Antitrust Defense or an Antitrust Attack?*, 1992 FORDHAM CORP. L. INST. 591, 603).

<sup>241</sup> See *id.*

<sup>242</sup> See J. R. Wilson, *Anatomy of a Merger*, 52 INTERAOVIA BUS. & TECH., June 1, 1997, at 44. For instance, it has been reported that the consolidation of activities from Boeing, McDonnell-Douglas, and Rockwell relating to the International Space Station will generate savings of \$20 million to \$25 million per year. See *Mergers Let Boeing Save \$25 Million a Year on Station*, AEROSPACE DAILY, Sept. 30, 1997, at 486.

<sup>243</sup> Before the merger, Boeing's activities were approximately 70% commercial and 30% military, while MDC's actions consisted of approximately 70% military and 30% commercial. Boeing predicted a post-

substantial efficiencies were anticipated in the commercial aircraft business as well. A few examples of the efficiencies expected on the commercial aircraft side will illustrate how the differing U.S. and EU laws were (or, in the case of the United States, *may have been*) applied by the relevant merger-review agencies. Consistent with the applicable law, the European Commission viewed most of them negatively while U.S. authorities likely viewed the efficiencies that were created either neutrally or slightly positively.

One benefit of the MDC acquisition for Boeing was an increase in capacity and flexibility. The merging of the production facilities, repair services, and support staff was expected to give Boeing much needed capacity at a time when the company was anticipating one of the largest increases in volume ever.<sup>244</sup> The European Commission explicitly noted that Boeing's dominant market position would be strengthened by the addition of capacity from MDC, explaining that "a manufacturer that can offer the required delivery slots in periods of rapidly increasing demand clearly has an advantage."<sup>245</sup> In addition to the added ability to meet future demand and possible returns to scale, the chief advantage of extra capacity is added flexibility. The acquisition of MDC's skilled engineers also had the potential to add to Boeing's flexibility. For example, as noted by the Commission, MDC's engineers who work on military transport aircraft (the C17) are particularly easy to switch to commercial aircraft production in times of increased demand.<sup>246</sup>

Similarly, the acquisition of MDC's complementary product line was expected to generate efficiencies. The European Commission cited the fact that Boeing had the advantage of

cost savings arising from commonality benefits, such as engineering spares inventory and flight crew qualifications . . . [which] are very influential in an airline's

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merger revenue split of 60/40% in favor of income from sale of commercial aircraft. See Wilson, *supra* note 242, at 44.

<sup>244</sup> See, e.g., *Boeing Posts Profit for Second Period, Reversing 95 Loss*, WALL ST. J., July 26, 1996, at A3 (stating that Boeing was expecting a "major production surge" and quoting sources familiar with the Company as stating that Boeing was expecting "record production" by 1999).

<sup>245</sup> EU Commission's Boeing Decision, *supra* note 81, ¶ 67, at 27.

<sup>246</sup> See *id.*

decision-making process for aircraft type selections and may frequently lead to the acquisition of a certain type of aircraft even if the price of competing products is lower.<sup>247</sup>

Substantial gains on the commercial side were expected from the synergy between the commercial and defense units, in particular the availability of research and development ("R&D") from the defense side to aid production on the commercial aircraft side.<sup>248</sup> The Commission was particularly concerned about this prospect, detailing at long length the immense amount of R&D funds that would go to the combined company.<sup>249</sup> In addition to the possibility of Boeing earning the use of this publicly funded technology at no cost to its commercial side, the Commission was concerned with the ability of Boeing's commercial side to use these R&D opportunities to increase general company know-how, and to take advantage of specialized equipment or tools purchased for the defense side.<sup>250</sup> The European Commission's opinion details different ways in which these advantages would enable Boeing to reduce its costs in designing and manufacturing commercial aircraft.<sup>251</sup>

A number of other efficiencies expected by the merger were reported in the media, such as returns to scale and reduction of duplicative services.<sup>252</sup> It has been reported that the Boeing/McDonnell-Douglas merger, merely by reducing duplicate services company-wide, could result in significant savings.<sup>253</sup> Even though McDonnell-Douglas made many fewer

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<sup>247</sup> *Id.* ¶ 41, at 22

<sup>248</sup> The EU Commission decision notes that Boeing disagreed with many of its factual conclusions regarding the extent to which its commercial side would benefit from MDC technology. *See id.* ¶ 97, at 33. Unless otherwise stated, this article assumes, for the sake of argument, that the European Union's conclusions are factually correct.

<sup>249</sup> *See id.* ¶¶ 84-93, at 30-32.

<sup>250</sup> *See id.* ¶ 92, at 32.

<sup>251</sup> *See id.*

<sup>252</sup> *See Lane, supra* note 79 (reporting commentators as saying that the merger would create synergies and reduce overhead costs); *see Mergers Let Boeing Save \$25 Million a Year on Station, supra* note 242 (discussing the savings generated by the post-merger consolidation of space station activities previously managed by Boeing and McDonnell Douglas); Wilson, *supra* note 242 (noting synergies in military helicopters and space and other benefits of the merger).

<sup>253</sup> *See id.*



planes than Boeing, its procedures are considered to be very efficient, resulting in better margins than Boeing realizes on most of its aircraft. In addition to the substantial returns to scale on R&D, many of the two companies' more than 400 laboratories, wind-tunnels, and test facilities offer duplicate services and can therefore be eliminated.<sup>254</sup>

The European Commission viewed Boeing's prospective improvements in flexibility, cost-structure, and financial resources with trepidation. Rather than focusing on the general welfare-enhancing effects, or assuming that these benefits would translate into gains for consumers, the Commission feared that the merger efficiencies would lead to an increase in Boeing's ability to exert market power and act independently of its consumers. As one example, the Commission suggested that post-merger it was possible, even likely, that Boeing could engage in a scheme of predatory pricing. The opinion claimed that the acquisition would insure Boeing a monopoly in both the 400+ jumbo jet market as well as the market for smaller aircraft. The European Commission believed that this situation would permit Boeing to charge supracompetitive prices in those markets in order to price at or below cost in the mid-size market, squeezing out Airbus entirely.<sup>255</sup> Although the Commission noted that a monopoly in the jumbo jet and smaller aircraft segments would likely have existed absent the merger, the vast increase in R&D funds and cost-savings made this possibility all the more likely,<sup>256</sup> especially given Airbus's weaker financial position because of its status as a mere consortium.<sup>257</sup>

The Commission believed that it had possible evidence of this abusive predatory pricing tactic already—against DAC. It cited an example, reported by the Washington Post, that:

SAS's [Scandinavian Airline Systems] internal evaluating committee had recommended the purchase of 50 of Douglas' proposed new 100-seat MD-95 jetliners for US \$

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<sup>254</sup> See Paul Proctor, *Lab Downsizing Expected*, AVIATION WEEK & SPACE TECH., June 16, 1997.

<sup>255</sup> See EU Commission's Boeing Decision, *supra* note 81, ¶¶ 78-79, at 29.

<sup>256</sup> See *id.* ¶¶ 78-81, at 29.

<sup>257</sup> See *id.* ¶ 76, at 29; see also *infra* notes 371-74 and accompanying text (discussing subsequent developments).

20 million each. Instead, [SAS Chairman] said that SAS would order 35 of a new version of Boeing's venerable 737 at about U.S. \$19 million per plane, a steep discount from Boeing's list price. "It was clear that Boeing's strategy was to prevent Douglas from ever launching the MD-95," recalled one salesman involved in the competition.<sup>258</sup>

The Commission went on to note that the lowest published 1996 price for the relevant 737 was U.S. \$ 32 million. Financial analysts calculate a likely 30% profit margin on the plane which would lead to a cost of U.S. \$ 22 million.<sup>259</sup> The analysis done by the Commission appears consistent with the earlier conclusion that EU law was much more hospitable to claims of predatory pricing.<sup>260</sup>

The preceding discussion illustrates how the European Commission developed a negative view of the Boeing/MDC merger's potential for creating efficiencies in the commercial aircraft market because of its concern with the single firm dominance. The FTC's explanatory statement, on the other hand, did not mention any efficiency issues at all. One of two conclusions appears likely from this omission, given the current U.S. position on efficiencies: (1) that the FTC viewed the merger not to be anti-competitive and therefore had no reason to discuss efficiencies, or (2) that the FTC may have viewed the merger as slightly anti-competitive, but found the large efficiencies to outweigh this small risk, and omitted this discussion in the final opinion.

In support of the view that the FTC did not consider efficiency at all is the fact that U.S. law and Pitofsky's writings seem to suggest that efficiencies will not be used to justify an anti-competitive merger in such a highly-concentrated industry.<sup>261</sup> The FTC, consistent with the focus on cartel-facilitation in U.S. law, may have concluded that the number of competitors in the market was the main (or only) issue, and blocking the merger would not prevent DAC's exit from the market.

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<sup>258</sup> EU Commission's Boeing Decision, *supra* note 81, ¶ 79, at 29.

<sup>259</sup> *See id.* ¶ 80, at 30.

<sup>260</sup> *See supra* text accompanying notes 46-49.

<sup>261</sup> *See supra* text accompanying notes 222-27.

However, the author believes that the second theory—that the FTC did take efficiency into account at some level, is more likely. This conclusion is reinforced by: (i) the author's determination, in Section 2.2., that the acquisition of MDC must be seen as raising some anti-competitive concerns, and (ii) the fact that it is highly unlikely that any policymaker could ignore the significant efficiencies that were expected to be generated by the merger—both in the production of commercial aircraft and on Boeing's defense side (see next section). It will be noted, however, that either theory if adopted by the FTC, would be entirely consistent with prior U.S. law and precedent—just as the EU's opposing conclusions were entirely consistent with EU precedent.

2.3.4. *A Further Complication for U.S. Authorities:  
Efficiencies and the Defense Industry*

A further complication in analyzing efficiencies in the Boeing/MDC merger is that the chief anti-competitive concerns centered around the commercial aircraft market, while a major purpose of the merger was to generate efficiencies relating to the space and defense markets. A number of issues are brought into play by this fact, among them: (1) should efficiencies generated in one market be permitted to offset anti-competitive effects in another, and (2) should antitrust authorities give more weight to efficiencies in the defense industry? Of particular interest here is how established U.S. law would answer these questions, and whether the FTC considered these issues when analyzing the Boeing/MDC merger and acted consistently with prior precedent.

The FTC and DOJ revised the efficiencies section of the 1992 Horizontal Merger Guidelines in 1997, adding relevant language on the issue of multi-market anti-competitive and efficiency effects. The Guidelines state that the agencies “will not challenge a merger if cognizable efficiencies are of a character and magnitude such that the merger is not likely to be anticompetitive in any relevant market.”<sup>262</sup> A footnote following this statement notes that § 7 of the Clayton Act “prohibits mergers that may substantially lessen competition ‘in any line of commerce . . . in any section of the country.’”<sup>263</sup> This suggests, and the Guidelines

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<sup>262</sup> Horizontal Merger Guidelines, *supra* note 10, § 4.

<sup>263</sup> *Id.* § 4, n.36.

confirm, that the agencies will normally judge anti-competitive effects in each relevant market independently.<sup>264</sup>

However, footnote thirty-six of the Guidelines goes on to state that:

In some cases, however, the Agency in its prosecutorial discretion will consider efficiencies not strictly in the relevant market, but so inextricably linked with it that a partial divestiture or other remedy could not feasibly eliminate the anti-competitive effect in the relevant market without sacrificing the efficiencies in the other market(s). Inextricably linked efficiencies rarely are a significant factor in the Agency's determination not to challenge a merger. They are most likely to make a difference when they are great and the likely anti-competitive effect in the relevant market(s) is small.<sup>265</sup>

It thus appears that the FTC believes that it may consider significant efficiencies in a related market when the two industries are "inextricably linked." Commentators have made that characterization about the commercial aircraft, space, and defense industries,<sup>266</sup> and indeed it appeared unlikely that there would be a buyer willing to purchase a divested DAC. The presence of such a buyer would have largely eliminated the antitrust concerns and permitted the defense and space divisions to merge.<sup>267</sup> The statement that the agencies are most likely to consider these effects when the efficiencies are great and the likely anti-competitive effects are small indicates that the context of the

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<sup>264</sup> See *id.*

<sup>265</sup> *Id.*

<sup>266</sup> See, e.g., *Peace in Our Time: Boeing v. Airbus*, *supra* note 54, at 59 (characterizing the commercial aircraft and defense industries as "joined at the hip").

<sup>267</sup> In addition to the likelihood that it would be practically difficult to separate DAC from MDC, it seems unlikely that another purchaser would be interested in DAC's commercial aircraft business as a stand-alone company. MDC itself appeared unable to keep the business operating profitably in the long run, and any independent company would probably do even worse. Airbus was probably not available as a purchaser because of its status as a consortium—i.e., not a true single entity or company.

Boeing/MDC merger may be precisely what the agencies had in mind when composing this footnote.

The agencies' decision to consider efficiencies created in interrelated markets, when divestiture of the related businesses is not possible, should not be surprising. The willingness to consider efficiency gains to balance off anti-competitive risk is a pure wealth/utility tradeoff. Requiring that both of these effects be in the same market seems excessively formalistic— unless one wishes to insure that the welfare gains go to the same group of consumers that receive the welfare losses. If, however, the agencies do view the requirement that the industries be “inextricably linked” as in furtherance of this goal, then the Boeing/MDC merger should not benefit from that characterization, since the consumer of defense-related products (the government) is not the same as the consumers of commercial aircraft.

There are a number of reasons why it has been argued that merger efficiencies in the defense industry should be viewed as particularly important. At the outset, it might be argued that U.S. national security depends highly on the defense sector, and that these concerns should be addressed by treating the sector differently. Although some may argue that the Department of Defense should police antitrust concerns in the defense industry given these unique concerns, “[f]or now, there appears to be a bureaucratic consensus on the application of antitrust regulations to mergers in the defense industry.”<sup>268</sup> Still, there remains the underlying fact that efficiencies relating to defense projects may be considered particularly important by a government body given that national interests, and not merely consumer satisfaction, are at stake. The U.S. Department of Defense sent a letter to the European Commission noting that failure to approve the Boeing/MDC merger “could harm important U.S. defen[s]e interests.”<sup>269</sup> Since even the EU opinion claimed to give some weight to U.S. “national interests. . . particularly those stemming from the consolidation of the U.S. defen[s]e industry,”<sup>270</sup> it seems unlikely that U.S. authorities gave no consideration to this issue.

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<sup>268</sup> Shwartz, *supra* note 70, at 376.

<sup>269</sup> EU Commission's Boeing Decision, *supra* note 81, ¶ 12, at 17.

<sup>270</sup> *Id.* ¶ 11, at 17.

In addition, the U.S. government (and taxpayers) stand to gain directly from any efficiencies generated by the merger as contract prices of most defense systems are based on costs.<sup>271</sup> This could be seen as guaranteeing that the benefits of the merger would not be confined solely to the merging parties, but would be "passed on." Especially when viewed in terms of the U.S. government bearing the cost of the excess defense capacity and overhead in the industry, this would appear to strongly support recognition that efficiencies will lead directly to welfare improvement.

It might be further argued that efficiencies in the defense sector should be weighed more heavily because the industry is in decline and is in need of restructuring. Although this rationale has not been used recently, there is U.S. Supreme Court precedent for this view in the case of *Appalachian Coals Inc. v. United States*.<sup>272</sup> Many well-known economists have concluded that arguments for permitting mergers in order to achieve efficiencies are particularly strong in the distressed industries setting.<sup>273</sup> For instance, Pitofsky's 1992 article advocated that "[i]n markets showing moderate concentration . . . mergers . . . among firms in distressed industries should be permitted . . . . [D]istressed industries are defined as industries with a long-term decline in sales . . . low profits . . . and substantial underutilization of capacity."<sup>274</sup> There is little doubt that the defense industry meets Pitofsky's definition of a distressed industry: defense procurement declined by more than 68% from 1986 to 1996,<sup>275</sup> and capacity in some firms was as low as 20-30% in 1997.<sup>276</sup>

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<sup>271</sup> See Lao, *supra* note 67, at 363.

<sup>272</sup> 288 U.S. 344 (1933) (finding certain cooperative practices not to be a violation of the antitrust laws because *inter alia*, they occurred in an industry in decline).

<sup>273</sup> See Pitofsky, *Proposals*, *supra* note 22, at 238, citing MICHAEL E. PORTER, *THE COMPETITIVE ADVANTAGE OF NATIONS* 663 (1990) ("The only consistent case for suspending competition in selected instances is to encourage the flow of resources out of structurally declining industries."); F.M. SCHERER & DAVID ROSS, *INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE* 164 (3d ed. 1992) (noting that "in declining industries, mergers enable least efficient units of production to be shut down").

<sup>274</sup> Pitofsky, *Proposals*, *supra* note 22, at 238.

<sup>275</sup> See Schwartz, *supra* note 70, at 329.

<sup>276</sup> See Lao, *supra* note 67, at 362-63.

In addition to the extra need for efficiency in a distressed industry, there is more reason to believe that efficiency claims in distressed industries—normally difficult to prove—are legitimate. One scholar notes that “defense firms have enormous fixed costs and . . . vast overcapacity . . . . [A] claim that a merger would enable the achievement of significant scale economies by eliminating duplicative or unproductive plants and facilities is most likely legitimate.”<sup>277</sup>

Unlike the general efficiencies defense, however, the current Merger Guidelines say nothing about mergers in distressed industries, so it is unclear as to how much the FTC would weigh considerations of this nature, if at all.<sup>278</sup> However, it can be concluded that if the FTC was willing to consider the efficiencies generated in the defense and space sectors, it is likely that it would not have had a difficult time finding immense and important efficiencies.

The FTC and Chairman Pitofsky have already expressed an interest in merger-produced efficiency gains. In addition, much current scholarship, including Chairman Pitofsky’s writings, suggest that an increased sensitivity to these concerns in the context of distressed industries, such as defense, is wise. Despite the expressed limitation of the efficiency defense (and distressed industry concerns) to cases of only moderate concentration, the author finds it difficult to believe that the FTC gave no positive value to the huge efficiencies to be created by the merger<sup>279</sup>—even if only on the defense side. This likelihood is strengthened by the fact that the consumers of defense-related products, and the U.S. government in particular, stood to gain directly from any merger-generated efficiencies. Had the FTC any reservations at all about the Boeing/MDC merger, this may be a case where incredibly

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<sup>277</sup> *Id.* at 380.

<sup>278</sup> It has also been argued that the monopsony of the defense industry (with the U.S. government as the sole buyer) is another reason not to challenge mergers in the defense industry. See Lao, *supra* note 67, at 351. However, it is enough to note that this argument is not relevant to the Boeing/MDC merger dispute, where the anti-competitive problems were in the commercial aircraft sector, not the defense sector.

<sup>279</sup> The remarks of Chairman Pitofsky lend more credence to this view. See Pitofsky, Staples Speech, *supra* note 42, at 6 (“Several of the ‘anti-competitive effects’ identified by the E.C. [in the de Havilland case, involving large market shares] would not be given much weight in an American court; indeed they might be regarded today as efficiency rather than anti-competitive effect.”).

high efficiency considerations overwhelmed a small but not insignificant risk of anti-competitive effects. In short, although the Horizontal Merger Guidelines maintain that "[e]fficiencies almost never justify a merger to monopoly or near monopoly,"<sup>280</sup> this may be a case where *almost* was the key word.

### 2.3.5. *In Sum*

As shown above, the two bodies' contrasting positions with respect to efficiencies expected from the Boeing/MDC merger were entirely consistent with—and almost to be expected from—previously existing differences in antitrust law. The European Commission correctly noted that Boeing's ability to exercise its market power in the commercial aircraft market would be strengthened by its acquisition of MDC, as well as the related merger efficiencies, and that no new entry could be expected to erode this position in the near future. The Commission further doubted that any efficiencies generated would be passed on to consumers through long-lasting price cuts. The FTC likely concluded that the vast efficiencies created by the merger do not make the merger anti-competitive under U.S. antitrust law, would not facilitate oligopolist pricing, and could even serve to offset any hypothetical, small, anti-competitive effects by means of lower prices and higher quality goods. The FTC may also have recognized efficiency gains in the interrelated defense sector, where efficiency gains are more probable, more crucial to industry survival, and more likely to be passed on to the primary purchaser because of cost-based pricing.

## 2.4. *The Exclusive Dealing Arrangements*

### 2.4.1. *U.S. Law*

U.S. law traditionally analyzes exclusive supply arrangements under Section 1 of the Sherman Act, using a rule of reason approach.<sup>281</sup> As a vertical non-price restraint (i.e., not an agreement between competitors), exclusive dealing arrangements

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<sup>280</sup> Horizontal Merger Guidelines, *supra* note 10, § 4.

<sup>281</sup> See, e.g., *U.S. Healthcare, Inc. v. Healthsource, Inc.*, 986 F.2d 589 (1st Cir. 1993).



are not viewed as inherently suspect under U.S. law.<sup>282</sup> U.S. law has identified a variety of procompetitive effects of exclusive dealing arrangements, including the fact that a buyer can engage in longer-term planning when assured of adequate supplies and predictable costs.<sup>283</sup> One recent U.S. appellate court decision noted that the possibility of exclusive deals may even *encourage* competition between firms in order to obtain the exclusive contract.<sup>284</sup> The court admitted, however, that this process may raise barriers against prospective entrants.<sup>285</sup>

Current U.S. antitrust law that identifies anticompetitive effects of exclusive dealing arrangements focuses on the extent to which the market is foreclosed to rivals by the exclusive contract. A high percentage of foreclosure suggests that competition by current competitors and new entrants will be substantially lessened by their lack of access to the foreclosed market.<sup>286</sup> Market foreclosure of 40% has been found to violate the antitrust laws,<sup>287</sup> and recent decisions and statements by the agencies have suggested that foreclosure of 20-30% may be the lower limit for illegality.<sup>288</sup> Longer lasting exclusive dealing arrangements will be examined with higher scrutiny, since they pose a more significant burden to competition.<sup>289</sup> In addition, the existence of high barriers to entry in the market may contribute to a finding of excessive foreclosure.<sup>290</sup> There is some evidence that U.S. authorities are becoming more concerned with exclusive dealings,

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<sup>282</sup> See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 59 (1977) (holding that vertical non-price restraints are subject to the rule of reason).

<sup>283</sup> See, e.g., *Standard Oil Co. of Cal. v. United States*, 337 U.S. 293, 306 (1949).

<sup>284</sup> See *Paddock Publications, Inc. v. Chicago Tribune Co.*, 103 F.3d 42 (7th Cir. 1996).

<sup>285</sup> See *id.* at 46-47.

<sup>286</sup> See, e.g., *Parikh v. Franklin Med. Ctr.*, 940 F. Supp. 395, 401 (D. Mass. 1996).

<sup>287</sup> See *FTC v. Motion Picture Adver. Serv. Co.*, 344 U.S. 392, 393 (1953).

<sup>288</sup> See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) (finding 30% to be insufficient for illegality without any direct evidence of foreclosure); *Dep't of Just. and FTC Statements of Enforcement Pol'y and Analytical Principles Relating to Health Care and Antitrust*, 4 Trade Reg. Rep. (CCH) §§ 13, 152, at 20, 787-88 (Sept. 30, 1994).

<sup>289</sup> See *Motion Picture Adver.*, 344 U.S. at 394 (agreeing with the FTC that the exclusive contract in question should be limited to one year).

<sup>290</sup> See, e.g., *Interface Group, Inc. v. Mass. Port Auth.*, 816 F.2d 9, 11 (1st Cir. 1987).

if the high profile 1990s cases involving Microsoft and Toys "R" Us are any guide.<sup>291</sup>

It should be understood that the preceding analysis is independent of merger-review law—it is done when analyzing whether the company has violated § 1 of the Sherman Act with the exclusive contract. Under U.S. law, the existence of a merger presumably will not have any effect on the legality of vertical agreements with third party suppliers, unless it would somehow increase the quantity or quality of the market foreclosed to competitors. Similarly, the prior existence of *legal* exclusive agreements is presumably not likely to be relevant in a merger analysis under § 7 of the Clayton Act, except to the extent that it may impact the likelihood of new entry<sup>292</sup> or the *General Dynamics*-type analysis of whether a given market share adequately represents a firm's future power in the market.<sup>293</sup>

#### 2.4.2. *EU Law*

Exclusive dealing contracts are viewed more suspiciously under EU law than under U.S. law. The legality of these arrangements is often raised, as in U.S. law, in the context of the general prohibition against agreements between firms that may restrict competition: in the European Union, anticompetitive effects of exclusive dealing contracts are analyzed under Article 85.<sup>294</sup> In addition, Article 86's prohibition against the "abuse of a dominant position" can also apply to the use of exclusive supply arrangements—even when the buyer suggests the terms.<sup>295</sup> The

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<sup>291</sup> See *United States v. Microsoft Corp.*, 56 F.3d 1448 (D.C. Cir. 1995) (challenging Microsoft's licensing of its operating system on a per-processor basis); *In re Toys "R" Us Corp.*, No. 9273, 1997 F.T.C. Lexis 284 (F.T.C. Sept. 25, 1997) (initial decision of the ALJ) (finding vertical agreements restricting distribution to be contrary to § 5 of the FTC Act); PHILIP AREEDA & LOUIS KAPLOW, *ANTITRUST ANALYSIS* 476 n.19 (5th ed. 1997) (suggesting that Microsoft's per processor licenses could be considered exclusive dealing arrangements). At the time of publication, the DOJ had yet another high-profile action pending against Microsoft in federal district court with respect to Microsoft's Windows software.

<sup>292</sup> See Horizontal Merger Guidelines, *supra* note 10, § 3.3.

<sup>293</sup> See *id.* § 1.521.

<sup>294</sup> See Treaty Establishing the European Economic Community, Mar. 25, 1957, art. 85, 298 U.N.T.S. 11, 47-48.

<sup>295</sup> See Richard P. Lewis, *Canadian Monopolies Law: Director Of Investigation and Research v. Nutrasweet Co., Decided As First Case Under Abuse-Of-Dominance Provision*, 25 CORNELL INT'L L.J. 437, 469 (1992) (citing Case

ECJ stated in *Hoffman-LaRoche* that exclusive supply contracts are:

[I]ncompatible with the objective of undistorted competition within the Common Market [because] . . . they are not based on an economic transaction which justifies this burden or benefit but are designed to deprive the purchaser of or restrict his possible choices of sources of supply and to deny other producers access to the market.<sup>296</sup>

This statement does, however, appear to rest on the assumption that the dominant firm is receiving most of the benefits of the transaction, which leaves open the possibility that the ECJ would be more sympathetic to transactions with greater “economic equivalency.”<sup>297</sup>

It was found in *Hoffman-LaRoche* to be a violation of Article 86 to give: (1) a “fidelity rebate,” which is a discount conditioned on the purchaser obtaining most or all of its product requirements from the dominant firm (and is not necessarily the same thing as a “quantity rebate” based on the seller’s economies of scale), and (2) a total purchase rebate, which creates similar incentives by calculating the rebate on the basis of total purchases of all products from the dominant firm.<sup>298</sup> In 1983, the ECJ used the same analysis in finding an abuse by Michelin giving distributors rebates for purchasing only Michelin tires, with a variable discount which appeared to act like a fidelity rebate.<sup>299</sup> One commentator summarizes the EU law by stating that:

The *Hoffman-LaRoche* and *Michelin* cases thus designate as abuse any conduct which places significant pressure on an enterprise to deal with a dominant enterprise unless (1)

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85/76, *Hoffman-LaRoche & Co. v. Commission*, 1979 E.C.R. 461, 539, 3 C.M.L.R. 211, 289 (1979)).

<sup>296</sup> *Hoffman-LaRoche*, 3 C.M.L.R. at 290.

<sup>297</sup> See David J. Gerber, *Law and the Abuse of Economic Power in Europe*, 62 TUL. L. REV. 57, 97 (1987).

<sup>298</sup> See *id.* at 95; see also Lewis, *supra* note 295, at 470.

<sup>299</sup> See Case 332/81, *N.V. Nederlandsche Banden-Industrie Michelin v. Commission*, 1983 E.C.R. 507, Common Mkt. Rep. (CCH) ¶ 14,031 (1983).

there is economic equivalency in the transactions, (2) the conduct has no significant effect on the structure of competition, or (3) the conduct is normal for non-dominant firms.<sup>300</sup>

In addition, the exclusive dealing arrangement is much more relevant under EU *merger* law because, unlike U.S. law, the focus of EU law is on what the merger's effect will be with respect to the creation or strengthening of a dominant firm. Since EU law under Article 86 appears to find exclusive dealings relevant in the analysis of firm dominance and the abuse of a dominant position, the ability of a merger to increase the likelihood or dangerousness of exclusive deals will directly impact the analysis of the merger's effect on the market and dominant firm.

#### 2.4.3. *Application of U.S. and EU Law to the Boeing Exclusive Dealing Arrangements*

In November 1996, Boeing and American Airlines entered into a long-term partnership that made Boeing American's exclusive aircraft supplier until the year 2018. American placed firm orders for more than 100 aircraft, plus purchase rights to more than 500 more.<sup>301</sup> A similar deal followed in March 1997 between Boeing and Delta Airlines. This deal again made Boeing Delta's exclusive supplier for twenty years, and Delta made more than 100 firm orders and more than 500 more purchase options of various types.<sup>302</sup> In June 1997, a third deal was signed with Continental Airlines, giving Boeing another twenty year exclusive supply agreement, with more than thirty firm orders.<sup>303</sup> Differing estimates, presumably depending on demand forecasts and valuing the purchase options, determined that these deals represented about 11-13% of the global market for relevant commercial aircraft.<sup>304</sup>

The FTC admitted that the exclusive supply deals that Boeing entered into with the three major airlines were "potentially

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<sup>300</sup> Gerber, *supra* note 297, at 97.

<sup>301</sup> See EU Commission's Boeing Decision, *supra* note 81, ¶ 43, at 23.

<sup>302</sup> See *id.* ¶ 44, at 23.

<sup>303</sup> See *id.*

<sup>304</sup> See *id.* ¶ 46, at 23 (estimating 13%); FTC Majority's July 1 Statement, *supra* note 80 (estimating 11%).

troubling.”<sup>305</sup> In particular, the FTC noted the barriers to competition that the agreements created, exacerbated by the fact that American, Delta, and Continental were only three of the mere handful of airlines with the prestige and scale to serve as “launch” customers for potentially new aircraft manufacturers.<sup>306</sup> The ability of any potential new entrant to reach a minimum efficient scale and achieve profitability—which would require a substantial initial order of new aircraft—is significantly decreased without access to major airlines capable of meeting much of the demand alone. The FTC, in approving the merger, concluded only that it “intend[s] to monitor the potential anti-competitive effects of these, and any future, long term exclusive contracts.”<sup>307</sup>

Subsequent statements have revealed that two major factors played into the FTC’s decision not to block or impose conditions on the Boeing/MDC merger relating to the exclusive dealing arrangements. First, the FTC recognized that the 11% market foreclosure was significantly below the 20-30% that appeared to be a relatively “safe harbor” under current U.S. Supreme Court precedent and agency practice.<sup>308</sup> Second, as mentioned earlier, there is no clear connection between prior exclusive dealing arrangements and the principal focus of U.S. merger law—the effect that a merger will have on competition and future prices. The General Counsel for the FTC recently stated that “the U.S. in Boeing’s case tended to regard the exclusives as business arrangements that antedated the merger and were not relevant to how the merger might change competition and prices.”<sup>309</sup>

One might question whether the FTC should have taken the exclusive dealing arrangements into account, in the manner permitted by *General Dynamics*,<sup>310</sup> either by lowering its estimates of the likelihood of market entry, or as evidence that Boeing’s

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<sup>305</sup> See FTC Majority’s July 1 Statement, *supra* note 80.

<sup>306</sup> See *id.*

<sup>307</sup> *Id.*

<sup>308</sup> See Robert Pitofsky, *Prepared Remarks for the Fordham Corporate Law Institute*, 24th Conference on International Antitrust Law and Policy (Oct. 16-17, 1997) transcript available at <<http://www.ftc.gov/speeches/pitofsky/fordham7.htm>> (citing *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 446 U.S. 2, 45-46 (1984) (O’Connor, J., concurring)).

<sup>309</sup> Valentine, *supra* note 39, at 532.

<sup>310</sup> See *United States v. General Dynamics Corp.*, 415 U.S. 486, 498 (1974).

market share may have been on the rise.<sup>311</sup> There is no evidence that these effects were considered. However, when analyzed in the context of U.S. merger law, it appears somewhat unlikely that considerations of this nature would have been substantial enough to challenge an otherwise acceptable merger.

The European Commission found the exclusive dealing arrangements to be much more problematic. The Commission's higher estimate of a 13% market foreclosure was viewed within a legal environment considerably more hostile to vertical agreements.<sup>312</sup> The Commission added, without explaining the relevance, the fact that these three airlines accounted for over 30% of the U.S. market.<sup>313</sup> The Commission also noted that the exclusive deals were not confined to one type of aircraft, which may reflect, although not explicitly, a recognition that these were not necessarily quantity discounts (based on economies of scale), but fidelity discounts.<sup>314</sup> This appears consistent with the following previously discussed EU economic assumption: "[T]he fidelity rebate, unlike quantity rebates exclusively linked with the volume of purchases from the producer concerned, is designed through the grant of a financial advantage to prevent customers from obtaining their supplies from competing producers."<sup>315</sup>

In addition, the exclusive deals were directly relevant under EU merger law, because they contributed to Boeing's dominant position in the market. The Commission first noted the position

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<sup>311</sup> American, Delta, and Continental all currently operate mixed fleets to varying degrees. Although all three have large amounts of MDC aircraft (47%, 27%, and 39%), only American had a significant percentage of Airbus aircraft in its then current fleet (35 of 663). See EU Commission's Boeing Decision, *supra* note 81, ¶ 69, at 27-28. This tends to suggest that Boeing's market share was likely to increase in the future with its new exclusive customers. However, it also suggests that Boeing already had much access to MDC customers even absent the merger.

<sup>312</sup> See, e.g., Spencer Weber Waller, *Understanding and Appreciating EC Competition Law*, 61 ANTITRUST L.J. 55, 66-69 (1992) (asserting that in antitrust law, the EU is more hostile than the U.S. to vertical agreements).

<sup>313</sup> See EU Commission's Boeing Decision, *supra* note 81, ¶ 46, at 23.

<sup>314</sup> See *id.* ¶¶ 43-46; cf. Case 85/76, *Hoffman-LaRoche & Co. AG v. Commission*, 1979-2 E.C.R. 461, 462, 3 C.M.L.R. 211, 290 (1979) (finding that the exclusive supply agreements were more suspect, because if a purchaser bought one type of vitamin from a different supplier, it would lose its rebate across the whole spectrum of vitamins bought from the dominant firm).

<sup>315</sup> Lewis, *supra* note 295, at 470 (quoting Case 85/76, *Hoffman-LaRoche & Co. v. Commission*, 1979-2 E.C.R. 461, 3 C.M.L.R. 211, 290 (1979)).

of these three airlines as crucial “launch customers”<sup>316</sup> which could otherwise facilitate new market entry.<sup>317</sup> The Commission went further, suggesting that the merger with McDonnell-Douglas would significantly enhance Boeing’s capacity to enter into *more* exclusive dealing arrangements, cutting off major parts of the market from competition.<sup>318</sup> The Commission reasoned that Boeing could now offer DAC aircraft and the provision of additional spare parts and repairs for older DAC models as part of the exclusive deals.<sup>319</sup> Furthermore, customers already having firm orders for DAC aircraft could be permitted to cancel these orders at no cost in return for exclusivity deals.<sup>320</sup> As evidence for this possibility, the Commission also stated that it is reported that Boeing offered to exchange previously delivered MD-90 airplanes with Delta in the context of negotiating an exclusivity deal.<sup>321</sup> The Commission also found it noteworthy that American, Delta, and Continental ranked first, third, and fourth respectively with respect to the size of their current MDC fleets,<sup>322</sup> and that “exclusivity deals had never before been entered into in the large commercial aircraft sector and that their duration itself is unprecedented.”<sup>323</sup>

The European Commission further found it “quite feasible” that Boeing would soon sign exclusivity deals with all of the top ten airlines, foreclosing over 40% of the world market from competitors.<sup>324</sup> Citing Boeing’s post-merger increases in product range and financial resources, the Commission feared a “knock-on” effect, whereby each major airline would find it necessary to gain the cost advantages and shorter lead time (due to Boeing’s higher capacity) that competitors were receiving by signing with Boeing.<sup>325</sup> Furthermore, the Commission reasoned that, given the current 28-31 year operating life of a large commercial airplane

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<sup>316</sup> See EU Commission’s Boeing Decision, *supra* note 81, ¶ 68, at 27.

<sup>317</sup> See *id.*

<sup>318</sup> See *id.*

<sup>319</sup> See *id.*

<sup>320</sup> See *id.*

<sup>321</sup> See *id.* When asked by the Commission, Boeing neither confirmed nor denied those arrangements. See *id.*

<sup>322</sup> See *id.* ¶ 69, at 27.

<sup>323</sup> See *id.*

<sup>324</sup> See *id.* ¶ 71, at 28.

<sup>325</sup> See *id.* ¶ 70, at 28.

and the costs of switching manufacturers after such a long relationship, the effects of the exclusive arrangements would last much longer than twenty years.<sup>326</sup>

#### 2.4.4. *In Sum*

The U.S. authorities' focus on the overall structure and concentration of the market—the crucial fact when assessing the likelihood of competitor coordination—resulted in vertical supply agreements appearing relatively outside of the scope of the U.S. merger review process. Although noting that these agreements were “potentially troubling” in their foreclosure effect, the authorities found that this effect was not large enough to warrant a challenge to the contracts under current U.S. law and its assumptions regarding the procompetitive benefits of vertical arrangements. The European Union, on the other hand, directly focused on the effects of the exclusive deals on Boeing's market position and was much more concerned. The European Union also operated in the context of economic assumptions that were comparatively more suspicious of vertical arrangements and in a legal context in which these contracts were extremely relevant to merger review. The Commission feared the ability of Boeing to use the exclusive deals to create monopoly power and clearly worried about the ability of Airbus (or any competitor) to compete against a merged firm armed with extensive exclusive supply contracts. The Commission further found that the merger would increase the ability of Boeing, the dominant firm, to sign similar exclusivity deals in the future, which would further strengthen its dominant position. In short, both authorities faithfully applied their laws, but with vastly different results.

### 3. BRIEF ANALYSIS AND CONCLUSION

#### 3.1. *The Settlement*

The European Commission approved the Boeing/MDC merger only after Boeing made numerous last minute concessions. First, Boeing agreed to a number of conditions designed to prevent its use of DAC to gain preferential access to its

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<sup>326</sup> See *id.* ¶ 71, at 28.



customers.<sup>327</sup> Boeing agreed to maintain DAC as a separate legal entity for 10 years.<sup>328</sup> Although Boeing has the right to manage DAC and make all relevant business decisions, it must make periodic reports certified by an independent auditor regarding the business performance of DAC and its commercial line.<sup>329</sup> Boeing agreed to maintain customer support for existing DAC aircraft at the same level of quality as that provided for Boeing aircraft.<sup>330</sup> Boeing also agreed that it would “not withhold or threaten to withhold support for DAC aircraft . . . or penalize” any customer because that customer intends to purchase aircraft from Airbus (or any other supplier), nor would it use preferential terms with regard to servicing DAC aircraft in return for purchases from Boeing.<sup>331</sup>

Second, Boeing agreed not to enforce any of the three exclusive supply agreements that it signed with Delta, American, and Continental.<sup>332</sup> Boeing also agreed that it would not sign any exclusive agreements with any purchaser until August 1, 2007.<sup>333</sup>

Third, Boeing agreed not to use its supply relationships against Airbus or other aircraft manufacturers.<sup>334</sup> Boeing agreed not to exert or attempt to exert “undue or improper influence on its suppliers” by methods such as promising higher purchases, subcontracting, or threatening to decrease these activities.<sup>335</sup> Boeing is prohibited from using these tactics to induce suppliers to limit their relationships with alternative manufacturers such as Airbus.<sup>336</sup>

Fourth, Boeing made a variety of agreements designed to limit the advantages that Boeing will enjoy from government related funding such as publicly funded R&D for MDC’s military projects. Boeing agreed to license any patents or “know-how” acquired through government funding to Airbus (or any other commercial aircraft manufacturer) at reasonable rates upon

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<sup>327</sup> See *id.* ¶ 115.

<sup>328</sup> See *id.* ¶ 115(1).

<sup>329</sup> See *id.*

<sup>330</sup> See *id.* ¶ 115(2).

<sup>331</sup> *Id.* ¶ 115(4).

<sup>332</sup> See *id.* ¶ 116.

<sup>333</sup> See *id.*

<sup>334</sup> See *id.* ¶ 119(1).

<sup>335</sup> *Id.*

<sup>336</sup> See *id.*

request,<sup>337</sup> and to file reports with the European Commission about unexpired patents for a period of ten years.<sup>338</sup> Boeing also agreed to supply information for ten years to the Commission relating to non-classified R&D projects that are being undertaken and to inform the Commission whether the project can be (or has been) applied to commercial aircraft.<sup>339</sup>

### 3.2. *Subsequent Events and Brief Analysis*

Having developed a clear understanding of why the two sides of the Atlantic disagreed so profoundly on whether the Boeing/MDC merger should be permitted, a brief substantive critique on the analyses described in the previous sections is appropriate. Making use of current economic understandings and two years of hindsight, this article will attempt to assess whether the Boeing/MDC episode sheds any light on either: (1) the wisdom of the priorities set by each merger review system, or (2) whether the economic assumptions used by each enforcement body have theoretical and empirical support.

#### 3.2.1. *The Competitive Significance of McDonnell-Douglas*

The apparent claim by the FTC that *General Dynamics* considerations alone were sufficient to justify the Boeing/MDC merger raises two questions with respect to the competitive significance of DAC: (1) is it plausible that the FTC truly believed that, based on the *General Dynamics* doctrine, Boeing's acquisition of DAC had zero anti-competitive effects, and (2) if the majority did silently extend the reasoning behind the failing firm defense in order to further justify this transaction, is this reasoning sound?

The FTC's claim that DAC had virtually zero competitive effect on the market, as a stand alone basis, seems questionable. A finding of zero anti-competitive effects would require evidence sufficient to invoke the *General Dynamics* doctrine to re-characterize MDC's market share from 4% to virtually 0%.<sup>340</sup> Previous cases that involved a finding of virtually no competitive significance appear to be much more extreme than the

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<sup>337</sup> See *id.* ¶ 117.

<sup>338</sup> See *id.*

<sup>339</sup> See *id.* ¶ 118.

<sup>340</sup> See *id.*

Boeing/MDC situation. The *General Dynamics* case itself involved contemporaneous market share data that was based on long-term coal supply contracts entered into many years before; however, one of the involved firms had absolutely zero remaining uncommitted coal reserves and was apparently unable to continue to supply the market.<sup>341</sup> In another case, *Citizens & Southern*, the acquired banks were found to already be operating as de facto branches of the acquiring bank so the merger was little more than a formality.<sup>342</sup> If the evidence given by Airbus to the European Commission about MDC's effect on prices is to be given any weight, it would appear that MDC did have some effect on prices in the very recent past, even if it is possible that this effect may not have continued significantly into the future.

It is difficult to believe that DAC's existence as a separate company would not have had some effect on prices in the commercial aircraft market. As late as June 1996, DAC was still considering plans for a new long-range aircraft, and American Airlines was contemplating purchasing it.<sup>343</sup> An American Airlines executive stated at that time that MDC was "a potential competitor in big airplanes."<sup>344</sup> Although MDC dropped plans for the MD-XX in the fall of 1996, signaling its uncertain future in the commercial aircraft market,<sup>345</sup> its existence as an "uncommitted entrant" still could have had a salutary effect on prices.<sup>346</sup>

In addition, although many conclude that the decision to concede the commercial aircraft market was a wise business decision, it has been suggested that merger decisions could be based on "strategic considerations" in anticipation of a possible

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<sup>341</sup> See *United States v. General Dynamics Corp.*, 415 U.S. 486 (1974).

<sup>342</sup> See *United States v. Citizens & S. Nat'l Bank*, 422 U.S. 86, 92-94, 99 (1975); *Hospital Corp. of Am. v. FTC*, 807 F.2d 1381, 1386 (7th Cir. 1986) (discussing the *Citizens & Southern* case).

<sup>343</sup> See Jeff Cole, *American Air May Weigh Buying McDonnell Douglas's Biggest Jets*, WALL ST. J., June 4, 1996, at B4.

<sup>344</sup> See *id.*

<sup>345</sup> See Anthony L. Velocci Jr., *MD-XX Termination May Seal Douglas' Fate*, AVIATION WK. & SPACE TECH., Nov. 4, 1996.

<sup>346</sup> See Horizontal Merger Guidelines, *supra* note 10, § 1.32. The guidelines define an uncommitted entrant as a "firm not currently producing or selling the relevant product in the relevant market." *Id.* The Agency will include these firms in the relevant market, however, if their "inclusion would more accurately reflect probable supply responses." *Id.*

merger,<sup>347</sup> and therefore, it is possible that MDC's decision could have been made in anticipation of a possible merger with Boeing. MDC abandoned its planned development of the MD-XX on October 28, 1996,<sup>348</sup> and by December 3, 1996, MDC and Boeing had signed an agreement to jointly develop a Boeing wide-body passenger jet.<sup>349</sup> The full scale merger was announced soon afterward, on December 15, 1996.<sup>350</sup> If any "strategic considerations" were indeed at play in this decision, these considerations increased the likelihood that MDC would have remained active in the commercial aircraft market absent approval of its merger with Boeing. However, analysts were predicting that MDC would need a merger partner before the merger was announced,<sup>351</sup> and the decision to avoid a new, risky investment of billions of dollars was probably no more than an attempt to maximize its share value in the face of stark market realities.

It is also difficult to accurately assess MDC's competitive significance, given the vastly different answers by the airlines surveyed by the FTC and the European Commission. Were different airlines surveyed (U.S. airlines vs. European airlines)? Did the different answers result from different types of questions? Additionally, one can question whether (or which) airline executives are truly aware of MDC's effect on prices, and why Airbus would choose to oppose a merger that would decrease competition, thereby increasing its ability to exert market power. Unfortunately, neither enforcement body commented on these questions, and a complete resolution of this issue is beyond the scope of this article.

The FTC failed to address the possibility that the acquisition of MDC would facilitate the exercise of market power by Boeing by increasing its post-merger market share. The majority

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<sup>347</sup> See, e.g., Statement of Commissioner Azcuenega, *supra* note 150.

<sup>348</sup> See John Mintz, *McDonnell Scraps Jumbo Jet; Firm Cites Competition; Move Follows Firing of Head of Military Unit*, WASH. POST, Oct. 29, 1996, at C-4.

<sup>349</sup> See Boeing, *McDonnell Douglas to Work Together: Deal's First Mission: Bigger 747s*, CHI. TRIB., Dec. 4, 1996, § 3, at 1.

<sup>350</sup> See Jeff Cole, *Air Power: Boeing Plan to Acquire McDonnell Douglas Bolsters Consolidation*, WALL ST. J., Dec. 16, 1996, at A1.

<sup>351</sup> See Anthony L. Velocci, Jr., *Market Focus*, AVIATION WK. & SPACE TECH., Nov. 25, 1996, at 11 (stating that MDC needs an acquisition, merger, or other strategic move in order to increase stock value after losing its quest for the Joint Strike Fighter).

statement appeared to give no weight whatsoever to Boeing's high market share and the effect of the merger in strengthening Boeing's market position with respect to suppliers and customers of MDC. Pitofsky himself has recognized the possibility of anti-competitive repercussions from the acquisition of a firm with little ability to compete on its own.<sup>352</sup> He stated in an article that "a failing firm's assets can be of immense competitive significance and the ability of a large firm to extract higher than competitive profits can be augmented by acquisition of those assets."<sup>353</sup> Given the evidence collected by the FTC regarding the lack of interest in future models and the subsequent progression of U.S. merger law towards a more lenient view, it is admittedly conceivable that the FTC commissioners could have truly viewed MDC's competitive significance as *de minimis*. However, this conclusion is neither obvious nor compelled from the facts.

Another important question that arises from the contrasting views on MDC's competitive significance is what would have happened if the merger was blocked. To this end, one might wonder whether Boeing would have decided to abandon the merger or merely attempted to acquire MDC and divest DAC. It appears to be highly unlikely that any other purchasers were available,<sup>354</sup> but it is at least a possibility that could have been considered more thoroughly.<sup>355</sup> Although the FTC appeared to analyze the merger in comparison to what would have happened without the acquisition (concluding that DAC would soon exit), the European Commission apparently measured the "strengthening" of Boeing's position in absolute terms. The Commission's analysis could have benefited from a stronger realization that it should judge how much the merger strengthened Boeing *relative* to how much the likely alternative—DAC's exit—would have strengthened the company.

If the merger was blocked, both the FTC and the European Commission assumed that MDC's commercial aircraft unit's assets would eventually leave the market. The European

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<sup>352</sup> See Pitofsky, *Proposals*, *supra* note 22, at 231.

<sup>353</sup> *Id.*

<sup>354</sup> See EU Commission's Boeing Decision, *supra* note 81, ¶¶ 58(iii), 60, at 25, 26; see also text accompanying note 202.

<sup>355</sup> Although the possibility of finding such a buyer was extremely unlikely, one analyst reportedly suggested Bombardier, Inc. See Velocci, *supra* note 351, at 11.

Commission implied that this result would be preferable, in that Boeing and Airbus could then compete on an equal footing for MDC's customers.<sup>356</sup> The European Commission also preferred this result because of the added flexibility and efficiency that MDC's work force could give to Boeing.<sup>357</sup> The FTC, however, could have implicitly adopted failing firm considerations, and believed that blocking the merger would have wasted assets that could have been put to good use by Boeing and needlessly punished shareholders and customers of MDC. The question arises, therefore, whether the underlying assumptions of each was valid.

It is questionable whether blocking the merger, at least in part, to prevent Boeing's access to MDC's skilled work force would have been effective at all. Since the European Union was concerned significantly with access to MDC's engineers in its defense and space side, the possibility that MDC would divest DAC would still allow the acquisition of most of MDC's engineers. Even ignoring this fact, however, it seems likely that some or most of MDC's commercial aircraft engineers would eventually have arrived at Boeing even absent the merger. Airbus does not have production facilities in the United States, and DAC operations and engineers, in Southern California, are not extraordinarily far from Boeing's hub of operations in Seattle.<sup>358</sup> In the event that MDC decided to spin off DAC rather than attempt to find a new merger partner, the DAC engineers would have had friends and contacts from MDC in Boeing. In fact, even before the full merger was announced, the collaborative deal that was announced on December 2 was largely meant to put MDC engineers to good use and involve MDC engineers from Long Beach in work in Seattle on Boeing aircraft.<sup>359</sup> A Boeing official, discussing the collaboration, stated that "McDonnell Douglas has excellent design and production capability—both in people and facilities—that are not being fully utilized . . . [w]e have a record number of orders for commercial jets and several ongoing

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<sup>356</sup> This issue is addressed below in the discussion relating to the exclusive dealing arrangements.

<sup>357</sup> See EU Commission's Boeing Decision, *supra* note 81, ¶ 65, at 26.

<sup>358</sup> In addition, with its acquisition of Rockwell, Boeing had operations in Southern California even without the addition of MDC. See Wilson, *supra* note 242, at 44.

<sup>359</sup> See Boeing, *McDonnell Douglas to Work Together*, *supra* note 349.

development programs.”<sup>360</sup> Thus, even absent a merger of DAC and Boeing, it is likely that MDC engineers and equipment would have found their way to Boeing’s commercial aircraft business.

The FTC’s use of failing firm or failing division considerations appears to be at least partly justified in that the loss of DAC’s assets would have meant a serious loss for shareholders and workers. The MD-95 has the potential to be a popular plane, but it probably would not have been worth much absent the combination with Boeing. Boeing has even considered creating an eighty seat version of the MD-95 for the below-100 seat market, in which Boeing traditionally did not compete,<sup>361</sup> and presumably it will supply the market with products it would otherwise have been without (at least at such a low cost). Similarly, if DAC workers and engineers were headed to Boeing anyway, it would seem irrational to require Boeing to build new production facilities in order to expand output, instead of merely allowing it access to the underutilized DAC plant in Long Beach.<sup>362</sup>

### 3.2.2. *Efficiency*

Efficiency generated by the Boeing/MDC merger can be expected to benefit Boeing itself and/or its customer airlines. It is, perhaps, not extremely surprising, given political and legal realities, that the European Commission did not give great weight to prospective gains to Boeing in terms of company profits. However, consideration of the possible cost-savings that could benefit European airlines when buying from Boeing were also absent from the European Commission’s written opinion on the merger. The European Union’s consideration of efficiency issues was likely hampered by questionable legal and economic assumptions regarding the following two issues: (1) the likelihood that Boeing would be able to use acquired efficiency gains to drive Airbus from a substantial portion of the commercial aircraft

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<sup>360</sup> *Id.*

<sup>361</sup> See Ralph Vartabedian & Karen Kaplan, *Rosy Post-Merger Future Painted for Douglas Plant, Aerospace: McDonnell and Boeing Chairmen Issue Upbeat Assessment for 19,100-member Work Force in Long Beach*, L.A. TIMES, July 24, 1997, at D1.

<sup>362</sup> Cf. Wilson, *supra* note 242, at 44 (“[G]iven the production levels at which the Long Beach facility is capable of running, compared to its current demand, Boeing should be able to move work into those plants far more quickly than they could have designed and built new facilities around Seattle and brought new workers up to speed.”).

market, which would allow Boeing to exert monopoly power in the market, and (2) the likelihood of significant efficiency gains being "passed on" to the consumers in the short and long term. A complete resolution of these issues is clearly beyond the scope of this article, but a brief comment is appropriate.

First, it is possible that the European Union ignored possible efficiency gains because of its fear that increasing Boeing's market share through efficiency and lower prices would lead, in the long run, to Boeing's market dominance and an ability to raise prices in the future to the detriment of its customer airlines. However, concerns of predatory pricing by Boeing run into one serious empirical obstacle: the ability of Boeing to recoup those losses in the future.<sup>363</sup> All political and economic factors point to the conclusion that a decision by Boeing to attempt below cost pricing in the hopes of driving Airbus and any other competitors out of the market would be pure folly. Initially, one should note that it is unlikely that Airbus would cede customers to a low-cost Boeing too quickly. Even at extremely low prices, the Airbus consortium has access to European governments who have already proven their ability and desire to keep the company afloat, even at the cost of high government subsidies.<sup>364</sup> Rightly or wrongly, given its public statements and history of subsidization, it seems doubtful that the European Union would permit Airbus to leave the entire commercial aircraft market to its transatlantic rival.

Further decreasing the likelihood of future recoupment is the strength and power of the airline industry. Major airlines are in a strong position to resist significant price increases, even in a future with Airbus confined to a much weaker market position. The market clout of major airlines is significant, and it is unlikely that they would be willing to pay supra-competitive prices for

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<sup>363</sup> Compare Boeing's situation to the situation in *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993), one of the leading U.S. Supreme Court cases on predatory pricing. In *Brooke Group Ltd.*, the Court refused to entertain a claim for predatory pricing because the plaintiff was unable to demonstrate a likelihood of recoupment.

<sup>364</sup> Boeing's continuous calls to end European subsidies to Airbus are still being rejected by the Europeans. See, e.g., Jeff Cole & John Simons, *U.S. and Boeing May Try to Limit Airbus*, WALL ST. J., July 13, 1999, at A3. European governments are expected to provide \$3.6 billion in loans in the event that Airbus develops its proposed A-3XX "superjumbo" jet to compete with Boeing's 747. See *id.*



Boeing aircraft without considering shifting consumption towards a weakened Airbus or a hypothetical new entrant.<sup>365</sup> It is doubtful that the airline industry would take actions causing Airbus to leave the aircraft market to a Boeing monopoly. In a recent illustration of the ability of the airlines to play the two aircraft manufacturing rivals against each other, Trans World Airlines ("TWA"), in the market for 100-seat aircraft, agreed to purchase fifty of Boeing's 717's, and seventy-five of Airbus' new A318.<sup>366</sup> As the Wall Street Journal reported, even the "financially strapped [TWA], which hasn't turned an annual profit since emerging from its second trip to bankruptcy court in 1995, succeeded in winning big discounts by pitting the two manufacturers against each other."<sup>367</sup>

Market regulators have also historically proven themselves unable to predict changes in market structure that can result from unanticipated innovations or other changes in technology and market practice.<sup>368</sup> The possibility of significant changes of this nature will further deter Boeing from engaging in the extraordinarily risky long-term strategy that predatory pricing would entail. This is especially true given the effect that below cost pricing would have on current share prices and shareholder support of management.<sup>369</sup>

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<sup>365</sup> See, e.g., Martha M. Hamilton, *Fare Hikes By Airlines; Dept. Probe Focuses on Pricing*, WASH. POST, Dec. 15, 1989, at F1 ("The Justice Department is investigating whether collusion was involved in fare increases earlier this year initiated by American Airlines and quickly followed by other carriers."). The airlines have proven their ability to exert market power when necessary. See *id.*

<sup>366</sup> See Frederic M. Biddle & Susan Carey, *TWA Orders Jets From Rivals Boeing, Airbus*, WALL ST. J., Dec. 10, 1998, at B2.

<sup>367</sup> *Id.*

<sup>368</sup> See, e.g., W. KIP VISCUSI ET. AL., *ECONOMICS OF REGULATION AND ANTITRUST*, 584-86 (2d ed. 1995) (discussing how regulators of the airline industry were unable to anticipate the market structure that would result when the market was left to its own devices and explaining that the "hub and spoke" system that eventually developed in the air travel market "points out an important lesson from economic regulation: it is difficult to predict what unfettered competition will generate"). The book also quotes Alfred E. Kahn, the former chairman of the CAB, for the following statement, "the essence of the case for competition is the impossibility of predicting most of its consequences." *Id.* at 586.

<sup>369</sup> Nor is Boeing immune to takeover threats. See, e.g., *Fearful Boeing: It May Come as a Shock, but Even Boeing's Bosses Admit That the Firm is Vulnerable to Predators*, ECONOMIST, Feb. 27-Mar. 5, 1999, at 59.

It is becoming increasingly clear that the projected efficiencies from the Boeing/MDC merger have resulted in and are continuing to spur the creation of a more efficient and modern Airbus to the benefit of all airline customers. Contrary to the European Union's fears, Airbus' position in the market looks strong; the company controlled 46% of the market for 100-plus seat passenger aircraft in 1998.<sup>370</sup> Airbus has also begun restructuring, not just to improve efficiency, but to make itself a better strategic partner for other foreign businesses.<sup>371</sup> The Boeing/MDC merger "prompted a far-reaching wave of activity by the Europeans to consolidate their own national aerospace companies into one big corporation that could deal with the new American giant and the other huge U.S. defense contractor, Lockheed Martin."<sup>372</sup>

Daimler Chrysler Aerospace AG ("DASA"), the successor Airbus partner formed when Daimler-Benz merged with Chrysler Corporation in November 1998,<sup>373</sup> recently agreed to purchase two of the other three Airbus partners: Aerospatiale and

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<sup>370</sup> It was reported that Airbus had 556 firm orders in 1998 compared to 656 for Boeing. See Charles Goldsmith, *Airbus Orders Hit a Record \$39 Billion in '98*, WALL ST. J., Jan. 12, 1999, at A14. Airbus has asserted that it actually had a higher share of the market than Boeing in 1997, citing the fact that its firm orders of 460 jets, when added to its preliminary orders of an additional 211, resulted in 671, compared to 568 for Boeing. See Charles Goldsmith, *Re-Engineering: After Trailing Boeing For Years, Airbus Aims For 50% of the Market*, WALL ST. J., March 16, 1998, at A1. Boeing contends that the better comparison is its 568 "announced" orders compared to Airbus' 460 firm orders. See *id.* Other reports from Boeing have suggested that Airbus' share of the market in terms of overall value is about 41.5%. See Ian Brodie, *Boeing Stuck on the Runway As Airbus Adds to Production Woes*, TIMES, Feb. 24, 1998. Preliminary indications were that Airbus surpassed Boeing in firm orders during the first nine months of 1999. See Daniel Michaels, *Keeping the 'Family' in Line Helps Airbus Beat Boeing on British Airways*, WALL ST. J., Oct. 12, 1999, at A6 (reporting that analysts believe Airbus recorded almost twice as many firm orders of aircraft as Boeing as of October 12, 1999).

<sup>371</sup> See *European Companies Seek to Consolidate: Restructuring Sought in a 4-Nation Consortium Competing Against Boeing*, BALTIMORE SUN, June 15, 1999, at 2D (noting European aerospace firms' consolidations in order to compete with U.S. rivals).

<sup>372</sup> See Martin Sieff, *Ready for Takeoff? Europeans Eye Consolidation of Aerospace Firms*, WASH. TIMES, Mar. 2, 1998, at A16.

<sup>373</sup> See Dagmar Aalund, *Car Merger Lends Boost to Profits*, WALL ST. J., Dec. 28, 1998, at A9; Daniel Michaels, *Daimler Deal with Casa Creates Inter-European Aviation Firm*, WALL ST. J., June 14, 1999, at A17.

CASA.<sup>374</sup> In retrospect, the European Commission's fears regarding possible predatory pricing driving Airbus from the market seem greatly exaggerated.

The second area where EU law may be operating under questionable legal and economic assumptions is in its analysis of the relevance and likelihood of efficiencies being "passed on" to customer airlines (and passengers). First, it will be noted that whether or not efficiency gains are passed on to consumers, these gains will still have a welfare-enhancing effect, although likely confined to the producer. Economic literature seems to support the view that efficiency gains to firms with strong market positions will still result in significant gains to society as a whole. In terms of total societal welfare, the leading commentator Oliver E. Williamson has noted that even moderate merger-generated efficiency gains can substantially outweigh the "deadweight loss" associated with a monopolistic price rise.<sup>375</sup> Williamson concluded that a mere 1.2% increase in efficiency will outweigh, in terms of allocative efficiency, the effects of a 10% price rise.<sup>376</sup>

Although the FTC did not address the issue of efficiencies, it could conceivably have found the efficiency gains to Boeing in terms of increased profit and gains to Boeing's shareholders (and possibly employees) as important, even absent these gains being "passed on" to consumers. However, if a stronger "passing on" requirement was applied by EU authorities, one might question the rationale behind this decision. The political reality is that, absent the "passing on" of efficiency gains to Boeing's customers, much of the efficiency gain in this case is likely to be concentrated

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<sup>374</sup> See Daniel Michaels & Charles Goldsmith, *Daimler and Aerospatiale Matra Agree to Combine Their Aerospace Business*, WALL ST. J., Oct. 15, 1999, at A3; Michaels, *supra* note 370.

<sup>375</sup> See Oliver E. Williamson, *Economics as an Antitrust Defense: The Welfare Tradeoffs*, AM. ECON. REV., Mar. 1968, at 18 [hereinafter Williamson, *Economics*]; Oliver E. Williamson, *Economics as an Antitrust Defense Revisited*, 125 U. PA. L. REV. 699, 708-09 (1977) [hereinafter Williamson, *Economics Revisited*]; see also W. KIP VISCUSI ET AL., *supra* note 368, at 203-06 (discussing the welfare tradeoffs of mergers and evaluating the Williamson model).

<sup>376</sup> See Williamson, *Economics*, *supra* note 375, at 22-23; Williamson, *Economics Revisited*, *supra* note 375, at 708-09. This author notes that merely analyzing overall welfare implications ignores important distributional effects on consumers. Nevertheless, if the relevant governments were truly concerned with the health of the commercial airlines, a direct transfer of wealth would be more effective than preventing efficient mergers with undesirable distributional effects.

in the U.S. market. This is due to the fact that the commercial aircraft industry is uniquely polarized with almost all of Boeing's production facilities in the United States and all of Airbus' in Europe.<sup>377</sup> Thus, the already existing EU resistance to efficiency considerations, especially absent those gains being passed on to consumers, may have been exacerbated in this case, given that the benefits from increased production efficiency and demand for Boeing aircraft may be concentrated in Boeing stockholders and workers who are likely mostly U.S. citizens. This raises a controversial question, unfortunately beyond the scope of this article, as to whether antitrust authorities engaged in a "Williamson Tradeoff"<sup>378</sup> analysis should be required to take into account gains that would accrue in foreign markets. The author will simply state his opinion that an honest antitrust enforcer concerned with total "social welfare" would be compelled, when dealing with international mergers, to take into account all international welfare effects when deciding whether or not to label a transaction as "anti-competitive."<sup>379</sup>

Second, even if one accepts the "passing on" requirement and focuses on consumer welfare alone, there is no reason to believe that efficiencies will not be passed on by Boeing to its customer airlines. At the very least, it must be admitted that substantial cost savings will most likely accrue to the U.S. government (and taxpayers) as a purchaser of defense equipment from the merged industry. One article even contends that the likelihood of efficiency gains being "passed on" to consumers actually *increases* with the market power of the merged firm, because smaller, price-

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<sup>377</sup> However, this does ignore the important effects of cross-border subcontracting. Boeing has extensive subcontracting activities in Europe, and has claimed, for example, that work related to its 737 alone may create over 30,000 jobs in France over eight years. See Frederic M. Biddle, *Boeing Goes European to Soothe EU Fears*, WALL ST. J., Oct. 8, 1997, at B6. Airbus similarly asserts that it affects over 80,000 U.S. workers by means of its U.S. subcontracting activities. See *id.*

<sup>378</sup> See Williamson, *Economics*, *supra* note 375, at 22-23 (discussing the welfare effects of mergers and the tradeoff of greater efficiency and the higher likelihood of anti-competitive activity); Williamson, *Economics Revisited*, *supra* note 375, at 708-09 (updating the original analysis).

<sup>379</sup> See Eleanor M. Fox & Janusz A. Ordover, *The Harmonization of Competition and Trade Law: The Case for Modest Linkages of Law and Limits to Parochial State Action*, WORLD COMPETITION L. & ECON. REV. Dec. 1995, at 5 (suggesting a model of "world welfare" to guide the international community towards substantive and procedural harmonization of antitrust law).

taking firms do not have much control over the prices they charge.<sup>380</sup>

The evidence seems to indicate that efficiency gains for Boeing/MDC, even outside the military sector, will indeed be enormous and much more significant than the negative effects associated with an increase in market power. Some evidence of merger-generated efficiencies being passed on to customers in the commercial aircraft market are already evident.<sup>381</sup> One example is the cost-reduction and spurring of competitive interest in the 100-seat plane market. The MD-95, which was started by MDC and continued by Boeing as the 717,<sup>382</sup> had a list price of \$30 to 35 million as of December 10, 1998.<sup>383</sup> As of April 4, 1998, Boeing reportedly was offering the plane for less than \$25 million.<sup>384</sup> Demand for the 717 appears to be on the rise since it has been in Boeing's hands in addition to the original launch customer for the aircraft, which is AirTran Airlines (formerly known as Valujet<sup>385</sup>), TWA has ordered the plane, and major European and Asian

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<sup>380</sup> See generally Paul L. Yde & Michael G. Vita, *Merger Efficiencies: Reconsidering the "Passing On" Requirement*, 64 ANTITRUST L. J. 735 (1996).

<sup>381</sup> Boeing executives suggested shortly after the merger that the distinction between their complementary military and commercial aircraft will be blurred in the future, and that, for instance, Boeing "may build military parts on commercial lines." Kevin O'Toole, *Defence Units Expect to Evade Boeing Axe*, FLIGHT INT'L, Feb. 11, 1998, at 20. In an example of efficiencies that may directly benefit airline companies, Boeing is reportedly now able to use wing-aerodynamics technology acquired from MDC to allow airlines to save 7% on fuel used for jumbo jets. See *For Their Next Trick: Airbus May Be About to Challenge the Jumbo Jet's 30 Year Old Monopoly. How Can Boeing Respond?*, ECONOMIST, Mar. 27-Apr. 2, 1999, at 61, 62.

<sup>382</sup> See Tim Smart, *Boeing Rolls Another 7: Manufacturer Predicts Strong 717 Market*, WASH. POST, Jan. 9, 1998, at G2 ("Boeing Co. yesterday rechristened the MD-95 narrow-body jet it inherited in its merger with McDonnell Douglas as the 717 . . .").

<sup>383</sup> See Biddle & Carey, *supra* note 366, at B2.

<sup>384</sup> See Frederic M. Biddle, *Boeing Unveils Ambitious Production Plan for New 717 Jetliner*, WALL ST. J., April 28, 1998, at A4. Production of the 717, however, has been plagued with production problems. See *id.*

<sup>385</sup> See *id.* For an interesting suggestion that the May 1996 Valujet crash may have been related to Valujet's relationship with the politically powerful MDC, see Jeff Shear, *Potentially Dangerous Liaisons*, NAT'L J., July 11, 1996. Shear notes that MDC produced both government and commercial aircraft in politically important California, that Valujet's crucial agreement to purchase MDC's MD-95 occurred in October 1995 (one year prior to the presidential election), and that the FAA chief, who had permitted Valujet to fly despite a variety of inspection problems, was previously an executive of MDC. See *id.*

leasing companies have also placed orders or expressed interest.<sup>386</sup> Furthermore, in a move certain to further benefit consumers, Airbus recently decided to proceed with plans to develop a rival 100-seat plane called the A-318.<sup>387</sup> It is not clear that these new values would have been fully available to customers absent the Boeing/MDC merger.

Shortly after the merger (although not directly because of the merger), the price of aircraft plunged. One Airbus executive stated that, between 1996 and 1998, prices dropped by as much as one-fifth, and operating margins at Boeing dropped to less than 3% in 1997,<sup>388</sup> and even lower in 1998.<sup>389</sup> The fierce price competition between Airbus and Boeing is not expected to lessen in the near future, so cutting costs is likely to be the only way to maintain profitability.<sup>390</sup> The benefits to the commercial airline industry of greater efficiency and lower prices are obvious. The Boeing/MDC merger and the efficiencies it created has spurred greater competition between Boeing and Airbus, as well as continuously decreasing prices, which benefit commercial airlines and passengers.<sup>391</sup>

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<sup>386</sup> See Biddle, *supra* note 384; Jeff Cole, *Airbus to Proceed with 100-Seat Plane, Clouding the Outlook for Boeing's Jet*, WALL ST. J., Apr. 20, 1999, at A4; Guy Norris, *Boeing Lines Up More Buyers For New 717*, FLIGHT INT'L, Feb. 18, 1998. Hawaiian Airlines agreed to purchase thirteen 717 jetliners; Jeff Cole & Susan Carey, *Boeing Co. Nears Hawaiian Air Deal for \$430 Million*, WALL ST. J., Sept. 23, 1999, at B14.

<sup>387</sup> See Cole, *Airbus to Proceed with 100-Seat Plane*, *supra* note 386.

<sup>388</sup> See Michael Skapinker, *Boeing, Boeing, Bong: Michael Skapinker on the Production Woes that Have Spoiled What Should Have Been a Bumper Period for the US Aircraft Maker*, FIN. TIMES (London), Feb. 6, 1998, at 19 (discussing the costly effect of production problems on an aircraft's profitability).

<sup>389</sup> See James Flanigan & Leslie Helm, *Brighter Skies for a New Boeing Aerospace: As the Turbulence in Commercial Aircraft Continues, the Firm is Cutting Costs and Fueling its Growth Through Military and Space Contracts*, L.A. TIMES, July 18, 1999, at C1.

<sup>390</sup> See *id.* Current information indicates that profit margins at Boeing decreased further in 1998, although they were expected to return to between 3.5% and 4.5% in 1999, and the company aims for 7%. See *id.*

<sup>391</sup> Interestingly, this situation of price competition and the absence of collusion was likely a large contributor to MDC's decision to abandon the commercial aircraft market. Although Boeing and Airbus were able to make significant profits even with low margins (presumably because of scale), MDC decided that the prices it would realize from the development of its new aircraft, the MD-XX, would be insubstantial. See Graham Warwick, *Where Next for MDC?*, FLIGHT INT'L, Nov. 6, 1996, at 28. MDC may have been unable to retain profitability absent collusion on price between itself, Boeing,

### 3.3.3. *Power over Suppliers and Customers?*

The buying power of Boeing over its major aircraft suppliers is indeed significant and could pose major dangers to the competitive environment. The European Union's fears that Northrop Grumman pulled out of its risk-sharing partnership with Airbus<sup>392</sup> due to pressure from Boeing may be compounded by the fear that Northrop's possible closer cooperation with Lockheed Martin would leave the companies extremely vulnerable to Boeing's influence.<sup>393</sup> Current information may indicate that Lockheed Martin is attempting to confine its competition with Boeing to the military side, thus refraining from direct support for Boeing's rivals in the commercial aircraft market.<sup>394</sup>

If the Boeing/MDC merger makes it more difficult for Airbus to embark on new projects, such as the A3XX, competition in the commercial aircraft market will be negatively affected. Not only would this increase the likelihood that Boeing will maintain its monopoly of the jumbo jet market, reaping super competitive profits with its 747, but the mere threat of the A3XX's introduction has the potential to remedy Boeing's leading firm lethargy and lack of innovation.<sup>395</sup> In fact, it has been reported that the threat posed by the A3XX has caused Boeing to re-evaluate whether its current jumbo jet product line is satisfactory given customer demand and has possibly spurred the creation of a new, larger version of the 747.<sup>396</sup>

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and Airbus. The public comments of then-MDC President Harry Stonecipher are illuminating and almost suspicious. He referred to pricing in the commercial aircraft market as "absolutely silly . . . we're in a situation of rapid growth in orders, yet the pricing is still marginal. Certainly it is for us." *Id.*

<sup>392</sup> See *supra* text accompanying note 199.

<sup>393</sup> In July 1998, the two companies abandoned plans for a merger after they were unable to settle disagreements with the DOJ, which had filed suit to block the merger. See Frederic M. Biddle & Thomas E. Ricks, *Lockheed Terminates Northrop Merger*, WALL ST. J., July 17, 1998, at A3.

<sup>394</sup> See Jeff Cole & Anne Marie Squeo, *Lockheed Martin, France's Aerospatiale Discuss Joint Military-Aircraft Venture*, WALL ST. J., June 11, 1999, at A14; Vago Muradian, *Lockheed Martin, France's Aerospatiale Discuss Partnership*, DEF. DAILY, Feb. 11, 1998.

<sup>395</sup> See *For Their Next Trick*, *supra* note 381, at 61.

<sup>396</sup> THE ECONOMIST reported that Boeing, after years of asserting that a new superjumbo jet was not needed in the commercial aircraft market, has begun consideration of a 550-seat 747. The best explanation for Boeing's change of heart is the A3XX. See *id.*; see also *Boeing Could Make Bigger 747 Models*

Nevertheless, one must question how much bargaining power Boeing truly has over companies such as Northrop and Lockheed Martin, given that a rift between these companies and Boeing could result in even closer cooperation between them and Airbus—a result that Boeing clearly would fear. In particular, “Lockheed Martin has made no secret of its desire to become more closely allied with Airbus.”<sup>397</sup> Although Lockheed Martin’s recent overtures to Airbus seem strictly confined to cooperation in military projects, links in the commercial market are not unlikely. Lockheed Martin’s position as a major competitor of Boeing in the defense sector will likely help to insure the company’s independence from Boeing. Furthermore, the likelihood of cooperation between Lockheed Martin and Airbus has increased now that Airbus is beginning to transform itself into a private company. The prospect of Lockheed Martin entering the commercial aircraft market as a risk-sharing partner in the A3XX, or even as an investor in Airbus in the event that it becomes a single private company, is appearing less remote than it has in the past.<sup>398</sup>

For the most part, Boeing’s bargaining power with respect to its primary customers (leasing companies and airlines)—although undoubtedly powerful—is based largely on the desirability of buying Boeing rather than on anti-competitive leverage or “dominance.” In other words, Boeing does not appear to be bullying the airlines into buying its planes. Instead, factors such as Boeing’s size and its technical know-how seem to permit it to offer an excellent product to its customers. Because of this fact, even with the undertakings by Boeing to the European Commission, it will be difficult to adequately police the line between “choosing a manufacturer forever and setting up

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*‘Superjumbo’ Airbus Jet Potential Rival*, HOUSTON CHRON., Sept. 21, 1999, at 4 (reporting that plans by Boeing to “go ahead with larger and longer-range versions of its 747 jetliner in the next two years” were likely the result of Boeing’s “hop[es] to stall a planned challenge from Airbus”).

<sup>397</sup> Muradian, *supra* note 394. Connections between the two companies could be further spurred by the fact that Lockheed Martin has expressed interest in working with Airbus to create a military transport plane for Europe. See *Transatlantic Aerobatics: The Defence Industry is One of the Last Bastions of Corporate Nationalism. But Now There are Signs that American and European Defence Companies Are Trying to Come Together*, ECONOMIST, June 5, 1999, at 59 [hereinafter *Transatlantic Aerobatics*].

<sup>398</sup> See *Transatlantic Aerobatics*, *supra* note 397.



exclusivity contracts which prevent airlines from changing their minds.”<sup>399</sup> The incentives identified by the European Union to sign large scale contracts with Boeing remain. Indeed, Delta has since signed another supply agreement with Boeing,<sup>400</sup> which may be an attempt to circumvent the Boeing/EU settlement. The result, as the European Union feared, will likely be strong dependence on Boeing by many major carriers in the long term, and market foreclosure for many launch customers. However, it is likely that this situation would have developed even without the merger.

The agreement between Delta and Boeing, combined with the fact that American and Continental have not indicated that they intend to purchase from Airbus, suggest that the exclusive agreements could very well have been equivalent, in the sense of providing true economic benefits for Boeing and the airlines. This view was also strengthened by the mid-1997 supply agreement between Airbus and the major U.S. carrier Northwest. Although not an exclusive supply contract, the agreement’s scale is similar to that of Boeing’s agreements; Northwest agreed to spend about \$2 billion for 50 Airbus planes and options for 100 more.<sup>401</sup> The Delta and Northwest developments suggest that large-scale purchase agreements, which are not so different from exclusive supply arrangements, result from the ability of each aircraft manufacturer to meet customer demands of price, quality, and stability—not from monopoly leveraging or single-firm dominance.

In addition, it is possible that the European Union’s concerns were excessive, in that market foreclosure concerns may be significantly lower in the commercial aircraft market. First, the likelihood of new entry into this market appears extremely low, so the existence of “launch customers” may be inconsequential. Second, in a market with only two sellers, even 13% foreclosure is not extremely significant in terms of overall market share—

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<sup>399</sup> *Delta, Boeing in Definitive Aircraft Agreements*, AEROSPACE DAILY, Oct. 23, 1997, at 122 (quoting a spokesman for EU Competition Commissioner Karel Van Miert).

<sup>400</sup> *See id.*

<sup>401</sup> *See Northwest Orders 50 Airbus Jetliners*, L.A. TIMES, Sept. 25, 1997, at D3. Northwest has already converted 30 of these options into firm orders. *See Northwest Airlines: Options on Airbus Jetliners Converted to Firm Orders*, WALL ST. J., June 18, 1999, at B2.

especially when large scale deals may be becoming the norm. Third, the airline industry is relatively concentrated and would likely move quickly to prevent the creation of a company capable of exerting monopoly power and raising prices for the industry. As one executive from Virgin Atlantic stated in explaining one of his airline's recent Airbus purchases, "Boeing makes excellent aircraft . . . but it is in the interest of both the aircraft industry and the consumer for them to have a strong competitor."<sup>402</sup> A spokesman from United Airlines suggested that United maintains a small amount of Airbus planes to preserve leverage over Boeing.<sup>403</sup> Thus, it appears that the mere existence of Boeing's three original exclusive deals neither demonstrated clear dominance nor altered the market too extensively.

#### 4. CONCLUSION

It has been demonstrated that historically differing legal philosophies regarding the purposes of merger control, combined with contrasting economic assumptions about the global marketplace, resulted inevitably in the U.S. and EU antitrust authorities profoundly disagreeing on whether to permit the merger of Boeing and McDonnell-Douglas. The FTC perceived a commercial aircraft market with only two significant competitors, and a transaction in which one of these competitors acquired a previously important but declining firm in the same line of business. Any doubts about the benefits of this transaction for the economy as a whole were likely allayed for the FTC by the likelihood of the creation of immense efficiencies in the commercial aircraft and defense industries, and the likely prevention of significant losses and layoffs in the acquired company's commercial aircraft division.

The European Commission, on the other hand, saw a commercial aircraft market that was being increasingly characterized by long term supply relationships with the leading firm that threatened to undermine the ability of the rivals to attract customers. The Commission perceived a transaction that

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<sup>402</sup> *The Underdog Bites Back—Airbus Exploits its Chief Political and Economic Asset: It's not Boeing*, SEATTLE TIMES, Aug. 17, 1997, at E1.

<sup>403</sup> The spokesman, Richard Martin said, "I think our actions speak for themselves in the fact that we operate aircraft from both manufacturers." *Id.* At the time the article ran, United maintained 42 Airbus narrowbodied planes and 500 Boeing planes. *See id.*

threatened to contribute powerfully to this trend and to provide the leading firm with immense financial resources, new technical skills, and unearned market share. The transaction would significantly increase the dominance of the leading commercial aircraft manufacturer, with undesirable economic and social repercussions for the global market.

This article will not attempt to conclude which enforcement body arrived at the correct answer, but it is clear that both bodies ignored important economic factors in their analysis of the Boeing/MDC merger. The FTC, concentrating predominantly on market-wide effects on prices and the likelihood of coordination between firms, failed to appreciate the significant danger of increased market-dominance by Boeing. By concentrating on MDC as a stand-alone concern, the FTC did not take into account the power of MDC in Boeing's hands, especially Boeing's increased market power resulting from its increased market share and privileged access to new customers and suppliers.

Furthermore, U.S. authorities, in doing their market analysis, could have benefited from a better appreciation of the effects that the MDC acquisition could have on Boeing's competitors—specifically Airbus. The previous wave of exclusive dealing arrangements threatened to foreclose many key customers to Airbus and/or hypothetical entrants, and Boeing's increased buying power threatened Airbus' attempts to challenge Boeing's monopoly of the jumbo aircraft market. It seems difficult to measure the implications of a merger on the commercial aircraft market without examining exactly how each aspect of the merger would affect the ability of other manufacturers to compete with Boeing.

By ignoring the effects of the merger on Airbus, the FTC was likely attempting to follow the wise counsel of the Supreme Court that U.S. antitrust law “protect[s] . . . *competition*, not *competitors*.”<sup>404</sup> Perhaps, however, the FTC neglected to consider the possibility that taking a more serious look at developments that could undermine Airbus's ability to compete might be the best way to maintain effective competition in the commercial

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<sup>404</sup> *Brown Shoe Co. v. United States*, 370 U.S. 294, 320 (1962) (emphasis added).

aircraft market. In other words, in this market, maybe to some extent protecting competitors *is* protecting competition.

The analysis of the European Commission would have been improved if the Commission had a better appreciation for the difficulty of showing "causation" in this case. In other words, the factors identified by the European Union that strengthened Boeing's market position may not have been solely a result of the merger. In analyzing how the MDC acquisition would "strengthen" Boeing's dominance, the Commission should have instead compared the increased dominance resulting from merger with the likelihood of increased dominance *absent* the merger. Many of the advantages identified by the Commission with regard to preferential access to MDC suppliers and customers would also, to an extent, have been available to Boeing had DAC left the commercial aircraft market without merging with Boeing. The most obvious example of this was the Commission's failure to appreciate that preventing the MDC acquisition would not likely succeed in eliminating Boeing's preferential access to MDC's U.S. employees.

Furthermore, the European Commission, saddled with an excessively narrowly focused merger regulation, exacerbated the situation by completely ignoring important economic and welfare effects of the Boeing/MDC merger. By focusing almost monomaniacally on the increased power of Boeing after the merger, the Commission failed to consider the immense efficiencies at stake with their corresponding benefits to global welfare. The result was an analysis that inadequately quantified the true benefits of the merger to the global market and to Europe, especially in terms of lower prices and more efficient manufacturing.

Similarly, the Commission skewed its analysis by treating merger-effects, that would strengthen Boeing by increasing its ability to satisfy its customers' demands, in the same way as merger-effects that would increase Boeing's ability to gain market share in a manner ultimately detrimental to its customers and airline passengers. The Commission's analysis, although consistent with EU law and previous practice, threatens to reject mergers that could ultimately be beneficial to the world economy, thus undermining the prospects for de-politicizing antitrust and obtaining limited global consensus on antitrust policy.

In conclusion, it should be recognized that the recent turbulence in U.S./EU relations resulted in part from a mostly

inaccurate portrayal of enforcement bodies acting not under rule of law but solely to protect their own “national champion.” Rather, the Boeing/McDonnell-Douglas merger should be seen as a case which highlighted important differences between U.S. and EU legal philosophies, enforcement priorities, and economic assumptions. This article attempted to highlight these differences and to question the wisdom of the choices made by each enforcement body when appropriate. The evidence suggests that both U.S. and EU antitrust regulators under-appreciate at least some important economic effects. The economies of the United States and the European Union, as well as relations between the two, would benefit greatly from the adoption of a more balanced and comprehensive approach.

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